ECONOMIC POLICY IN NEW ZEALAND.

1936 - 1939.

UNIVERSITY OF NEW ZEALAND.

ECONOMIC POLICY IN NEW ZEALAND 1936 - 1939.

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D.W. [signature]

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CHAPTER I

INTRODUCTION.

The aim of this survey is twofold. First, it attempts to describe and analyse the more important aspects of the Labour Government's economic policy, and second, it attempts to demonstrate how the achievement of this policy is conditioned by the characteristics of the New Zealand economy.

The economic policy of the Labour Government is important for several reasons. First, both the "recovery measures" of the previous Government during the depression, and Labour's policy after the depression tend to show that New Zealand, in common with other countries, is experiencing a definite trend towards an extension of State control of economic life. Secondly, since the 1890's the Dominion has indulged in economic and social experiments which have attracted the attention of economists not only in New Zealand but also abroad. The economic and social policy of the Labour Government thus appears to be an acceleration of this long term trend. In addition it is generally recognised that conditions in New Zealand are more favourable to economic experimentation than those existing in most other countries. In examining this policy it is of fundamental importance to realise that the Ottawa Agreements of 1932, mark the end of an era when New Zealand could confidently rely on a large and expanding overseas market for her exports. Moreover the rise of economic rationalism, the progress of agrarian protectionism, the developments in the alternative sources of supply and the declining rate of growth of population in the consuming countries, all have forcibly demonstrated the inherent weakness of the New Zealand economy. Consequently the post depression years have witnessed a conscious expansion of New Zealand's secondary industries. Although the social and economic policy of the Labour Government is in many respects similar to that of the Liberal Administration of Ballance and Seddon in the early 'nineties' of last century, it has certainly been carried out under far less favourable circumstances.

It is mainly for these reasons that this subject provides a fruitful field for economic research.

To cover the whole of the policy in detail would be beyond the limits of a brief survey of this nature. It would be possible to write a detailed survey on any one aspect of the policy. Nevertheless, it is felt that a broad treatment of policy is not entirely unfruitful. On the contrary a wide survey has much to commend it, for a detailed analysis of one aspect only tends to lose sight of the nature of the policy as a whole.

Thus the first two chapters are devoted to an analysis of the Labour Government's Programme and the economic factors limiting the achievement of this programme. The remaining chapters are concerned with the development of policy. Separate chapters deal in turn with Monetary Policy, Marketing, Transport, Rationalisation of Industry, Import and Exchange Control, and Labour and Social Legislation. In a concluding chapter, the threads are drawn together and an evaluation of the policy attemtped.

It should be noted that the period under review extends from 1936 to 1939 inclusive. It does not deal with the policy after the outbreak of war in September 1939, because this has created new problems and has thus modified to a certain extent the direction of Government policy.

At the outset, originality is disclaimed. Much has already been written on particular aspects of policy, but little if any, on the policy as a whole. The material has been collected from all available relevant literature, consisting of numerous pamphlets, periodicals, articles and officials publications. A detailed account of references is given in the bibliography.

Finally It is not proposed to reveal anything which is not already known to competent economists. This survey merely aims to amke a comprehensive and critical analysis of the economic policy followed by the Labour Government in the years 1936 - 39.

CHAPTER II.

THE PROGRAMME.

I. Labour's Programme.

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III. Limitations.

I. Labour's Programme.

The foundations of the present Labour Government's policy were laid down at a party conference in April 1933, at a time when New Zealand was facing a critical stage of the worst economic depression in its history. Under such conditions it is not at all surprising that the policy should prove more applicable to the conditions then prevailing, than to those which were actually in existence when Labour came into office at the end of 1935.

It is worthy of note that the New Zealand Labour Party has always had as an important plank in its political programme the complete state ownership and control of the machinery of currency and credit. This plank has been emphasised over the years. Moreover during the great depression when deflation succeeded under consumption the interest of the community in "monetary reform" became all absorbing. Throughout the entire country, organisations and societies, lecturers and writers, who severely criticised orthodox finance and advocated "unorthodox monetary reform" recruited willing supporters from the ranks of all sections of the community suffering economic hardship and distress. Chief amongst these monetary reformers was the Douglas Social Credit Party. By laying great emphasis on the abuses and short-comings of the existing financial system it swept New Zealand like a religious revival. The very difficulty of understanding Douglas with his algebraic symbols and theorems rendered the public more willing to listen to the Douglas Movement's critical analysis of capitalist finance. But although this movement withered away, almost as rapidly as it had blossomed it succeeded in arousing public opinion to the belief in the necessity for change. It is then not surprising that the Labour Party's programme, with emphasis placed on monetary reform, and which had the twofold advantage of being apparently practical and positive, should have captured the imagination of the voters. In addition, although Labour professed a socialistic aim, yet in practice it sought to bring about social and economic reform within the framework of capitalism. To secure power, the Party had to expand into the rural electorates from its deeply entrenched position in the cities. It had to cope with two major problems: first unemployment and secondly the financial difficulties of the small farmers. The policy had to be one of compromise on issues of conviction and expediency. To secure its widest appeal then, Labour must be neither inconsistent with capitalism nor with the possibility of eventual progress towards socialism. At best Labour must offer better wages, shorter hours and social services for all, and so operate a programme of social controls and readjustments.

The Labour Party placed their financial policy in the forefront of their programme and prefaced this policy with a "preamble", in connection with which all the machinery proposals were to be read. The preamble and programme were as follows:-

Preamble:[1]

"The Purpose of Production: The purpose of all production, primary and secondary, is to supply the social and economic requirements of the people, and the duty of the State is to organise productive and distributive agencies in order to utilise the natural resources for this purpose.

"Only a courageous and vigorous policy can save our country. The policy of deflation has been pursued to such an extent that if there were an equitable distribution of existing income, it would not be sufficient to allow thousands of householders, farmers, and business men to become solvent. A policy must start either from a foundation of wholesale repudiation and bankruptcy or else we must organise the development of industry and extend the social services to increase the income of the people so as to provide an adequate standared of living and enable them to meet their present commitments. The chaotic state of the world has already reduced prices of exports to ruinous levels, and our present economic condition is, to a large extent, due to the fact that New Zealand currency and credit is determined by overseas prices.

"Credit Basis. Overseas prices and conditions cannot any longer be allowed to dictate New Zealand's living standard. By proper planning of production, with control of marketing and finance, New Zealand can establish her own standard. The basis of all credit and currency must be production (goods and services).

"This basis can only be established and maintained by expanding the incomes of the mass of the people in accord with production and their social and economic requirements.

"Equities in land and homes which have been endangered by the deflationary policy of the Government (Coates and Forbes), should be re-established on the basis of an average of wholesale prices ruling during the past seven years. Present occupiers of land and homes must be safeguarded against foreclosure pending the stabilisation of internal prices on a basis which will allow them to meet their commitments.

"Unemployment: The workers today unemployed are our fellow citizens who are out of work through no fault of their own. They

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1. Lee. John A. Socialism in New Zealand p 49.

are entitled to employment at a living wage. Failing such employment they should be paid a sustenance wage sufficient to provide the necessaries of life for them and their dependants. The conditions of pay for men on relief works are a standing disgrace to the Dominion. The existing degrading system should be abolished at the earliest possible moment. The Party will organise productive development for all who are able to do it, including present relief workers, unemployed women and youths who are leaving our schools. Pending organisation of employment, the Party will immediately increase the present rates of pay for relief workers.

"<u>Guaranteed Prices.</u> Guaranteed prices, organised employment in primary and secondary industries, with a vigorous public works policy, local and national, at wages and salaries based on national production will ensure to the farmer on the land, the worker in industry and all others an income, that will maintain a standard of living to which the people of the Dominion are entitled. The ruinous policy of deflation and bankruptcy has been consistently opposed by Labour, and we affirm a complete reversal of the Government's policy and the economic management of the country generally has become a necessity of first magnitude".

The Ten Points elaborated in the Manifesto were:-

(1) State control of Banking and Credit.

(2) Removal of restrictions on deposits in the Post Office Saving Bank.

(3) Reorganisation of the Mortgage Corporation into a State Advances institution.

(4) Guaranteed prices for the farmers and negotiations of reciprocal trading agreements with Great Britain and other countries.

(5) Statutory minimum wages and salaries.

(6) A National Health Service.

(7) National Superannuation.

(8) Extension of Education facilities.

(9) Organisation of employment, with immediate increase of rates of relief pay and expansion of public works."One of

the first steps of the Labour Government will be to ensure a full share of the national production to those who are willing to work."

(10) The fostering of such secondary industries "as can produce commodities economically" for the "maintenance and improvement of our standard of living if imports do not expand in proportion to the population."

The appeal of this programme to self interest and social sympathies of different sections of the community resulted in a sweeping victory for Labour at the 1935 elections, enabling the new Government to assume office full of confidence. Even if Labour were correct in assuming that a more liberal policy of borrowing and spending especially on major public works would prove a corrective for unemployment and would increase consumption, they most certainly lost sight of the fact that export income of the Dominion sets definite limitations on the standard of living of its people.

II Methods of Achievement.

(1) Increasing production and employment through the use of "Public Credit".

The immediate aim of the Government was to decrease unemployment. The reorganisation of the Reserve Bank under the legislation enacted early in 1936 provided facilities for stimulating employment through various channels. The Reserve Bank was empowered for instance to make advances for such state undertakings as Public Works,housing and establishment of industries.

(2) Increasing employment through Government spending, involving redistribution of income.

It was considered possible to increase employment and wage rates by increasing the numbers in the various Government services, including Public Works. Consequently there was a considerable expansion of employment in public services, together with a transfer of workers from relief work to full time employment at standard rates of pay.

(3) Increasing employment, raising the standard of living through statutory hours and wages.

Here the main aim was to increase money wages. Measures were immediately taken to shorten working hours and to fix a basic wage, both in industry and agriculture. In this policy there was the danger of the emergence of a vicious spiral of higher wages, costs and prices but this important point was overlooked by the Government in its first term of office.

(4) Redistribution through Social Services.

It was by making considerable expansion of the Social Sefvices, rather than by changing the incidence of taxation that the Government endeavoured to make redistribution effective. The increases in education, health services and pensions was aimed at raising the real incomes of the lower income groups. The principal Act dealing with this aspect of Government policy was the Social Security Act of 1938 which although a measure of considerable redistributive value, created a severe financial problem for the Government.

(5) Expansion of Secondary Industries.

It was the aim of the Government to increase both production and efficiency in primary and secondary industry. The Government proposed an extension of the activities of the Department of Agriculture, the New Zealand Dairy Board and kindred public organisations with a view to increasing the efficiency of farming. It also brought forward an Industrial Efficient Act designed to promote "the most economic form and organisation of industry".

(6) Stabilisation.

It was desired that the measures as a whole would provide a means of stabilising the incomes and employment within the Dominion. Much prominence was given to a policy of "insulation", and although exchange and import control were not put into operation until Labour's second term of office, these measures were hinted at in the original programme of the Party.

III Limitations of the Programme.

From the outset there were many factors which tended to limit the success of the above policy.

Chief among these was the "dependence" of the New Zealand economy. Whether we like it or not, export income and overseas trade relations set very definite limitations on the standard of living and degree of internal economic activity of the Dominion. New Zealand has attained a high degree of specialisation in her agricultural and pastoral industries; she is desperately lacking in heavy industries; she must depend upon overseas markets for supplies of raw materials, semi-finished goods and capital equipment, and she has a large balance of financial obligations due overseas each year. And secondly this programme suffered from a considerable admixture of muddled thinking on the part of those responsible for carrying it out. In this connection a comment of J.M.Keynes is most interesting.

"It sounds to me as though the aims of your new Government are partly admirable but in serious danger of proving a fiasco from the admixture of muddled thinking which lies behind them."[1]

It was nowhere suggested that New Zealand should adopt a policy of self sufficiency and withdraw from world trade. She was still to benefit from international trade and at the same time secure herself against fluctuations in export prices. One effect of this policy was to cause some serious difficulties for the Government in relation to costs, profits and the export of capital.

Actually the Government's policy called not for stabilisation but for steady and continuous expansion of both money

1 Quote from Lee,J.A. op.cit.p3

incomes and production. But increased spending within New Zealand would merely raise the volume and value of imports, while any expansion of domestic industry must necessarily involve increased imports of raw materials and producers' good. Thus the more rapid the attempted rate of expansion, the more imports increase and these in turn depend upon export prices. The central problem then would be one of conserving sterling exchange and regulating the rate of progress in conformity with the amount of sterling available. The programme was limited also by the fact that some expansion had already taken place, the relative shortage of skilled labour available in New Zealand and that an inevitable lag must arise before extensions and new factories could be established. In addition any increased saving would cause difficulties on account of the limited nature of New Zealand's capital market. There would be a tendency for investors to seek the more highly organised capital markets beyond the Dominion. This would cause a contraction in sterling exchange and may be one factor in the subsequent decline of the funds at a later date.

These are some of the more important limitations on this policy and difficulties with which the Government would ultimately have to cope. After having considered the characteristics of the New Zealand economy and the economic and monetary condition of New Zealand in 1936, then an attempt will be made to describe and the more important economic experiments of the Labour Government.

CHAPTER III.

NEW ZEALAND: ECONOMIC FACTORS.

I. Characteristics of the New Zealand Economy.

In order to understand fully, and to place in their true perspective the economic experiments undertaken by the Labour Government, it is of prime importance that we have some knowledge, however brief, of the characteristics of the New Zealand economy. There are still far too many who possess a vague idea only, of the manner in which the characteristics influence and impose very definite limitations upon our prosperity and upon any internal policy of economic planning. We shall deal briefly with some of the main features of our economy and then draw certain inferences which seem to be important.

1. Production. For the year 1937 - 38 the value of production was distributed as follows among the different classes of industry.

Class of Production	£ N.Z.m		%
Agricultural	8·6		
Pastoral.	40·7		
Dairying, Poultry etc.	33.8		
Total Farming.		83.1	61
Mining.	4.6		
Fisheries.	0.6		
Forestry.	4.1		
Factory.	30.0		
Building etc.	13.2		
Total Non-Farming.		52.5	39
Grand Total.		135.6	100

This table includes only the value of goods produced at wholesale prices: it does not include other services except in so far as they are embodied in the wholesale prices of goods. The added value of processing, namely butter and cheese making, meat freezing etc. is included in the farm group. The figures exclude retail distribution, passenger transport, medical services, and many public services such as education.

The most outstanding feature of this table is the high relative importance of farming industries in the national economy, 61% of the value of total production being the product of these industries. During the past twenty five years the value of farm production has varied from 60 to 65 per cent of the value of total production, the variations being due mainly, to increases in the volume of farm products.

This pre-dominant importance of farming production is due to the fact that New Zealand possesses conditions of soil and climate which are highly favourable to these industries and to the large overseas markets in Great Britain. On the whole efficient farming techniques have been developed to exploit the country's natural advantages and these in turn have been supported by efficient systems of processing, transport and marketing.

On the other hand New Zealand is not favourably endowed with the conditions necessary to develop a high degree of industrial activity. New Zealand suffers from a relative paucity of raw materials for the heavy industries, such as iron and steel, and a small domestic market. In addition even this small market is sub-divided into smaller markets by the high cost of transportation, arising from the impediments imposed by topography. Labour costs, too, are high in New Zealand, owing largely to the existence of labour codes and militant trade unions. Despite these impediments to the establishment of large scale secondary industries, a considerable degree of manufacturing development has taken place, especially in connection with the protected or sheltered clothing industries, furniture making, building etc. where economical production does not necessitate large scale production. Generally however, the size of the industrial establishment is small. The following table will make this point clear.

Size of Factories.
(1936 - 37)

Persons per factory.	No. Factories.	Total No. Employees.
2 - 10	3858	15,953
11 - 20	842	12,444
21 - 50	667	20,281
51 -100	198	13,531
Over 100	163	34,192
Total.	5728	96,401

Our survey so far makes it quite clear that New Zealand is exceptionally well adapted for farm production, especially sheep and dairy farming and much less adapted for manufacturing production.

2. External Trade.
The unique advantages in farm production, and the relative disadvantages in manufacture are reflected with very great importance, in external trade, which is higher per head of population than in any other country. Expressed in New Zealand currency the value of exports was £36 6s 8d per head of population in 1938; imports were valued at £34 9s 10d per head and the value of total trade was £70 16s 6d per head. The value of exports and imports are usually high in relation to the total value of production. For the season 1937 - 38 the totals were:

Value of:	£ N.Z. m.
Production.	135.6
Farm Production.	83.1
Exports.	61.9
Imports.	57.5

During recent years pastoral products, mainly meat, wool, dairy produce, hides and so on, have provided from 92 to 95 per cent of the value of all exports, the remainder being mining, agricultural, and forestry products. The value of exports has usually been about 44 per cent of the value of all production and farming exports have been from 65 to 70 per cent of the value of farm production.

Imports cover a wide variety of items, but the following table gives a broad classification of the imports for 1937-38.

Class.	£ N.Z. m.
Food, Drink and Tobacco.	6.7
Raw Materials etc.	1.95
Manufactured or semi-manufactured.	47.20
Other.	1.65
Total.	57.50.

Of these imports about 47.9 per cent came from the United Kingdom, 25.7 per cent from other Empire countries, and about 26 per cent from foreign countries, the most important of which was the United States.

3. Financial Relations. In the past the economic resources of New Zealand have been developed largely by money borrowed from overseas, especially from Britain, with the result that both public and private indebtedness is exceptionally heavy.

Government and Local Body Debt on 31st March 1939
£. N.Z.m.

Domocile	Government	Local Body.
United Kingdom	156.86	13.86
Australia	.883	2.17
New Zealand	132.46	50.93
Total	290.20	66.96

From the above table it will be noticed that 54 percent of Government debt was held in the United Kingdom and 45.6 per-cent in New Zealand; 26 percent of Local Body debt was held in the United Kingdom and 76 percent in New Zealand. The annual interest payable on Government and Local Body debt was £ N.Z.13.5 million of which £ N.Z.8.5 millions was payable overseas. To this figure must be added the interest payable on private debt, insurance premiums,,shipping charges and other items, making a total of about £ N.Z.12 milliom. Thus if New Zealand is to pay her way, exports must exceed imports in value by at least £ N.Z. 12 million per year.

It is important to realise that interest and other financial charges remain fixed in terms of money. They are paid for out of export receipts. Hence if the prices of exports fall, more exports are required to pay the interest on the bill and fewer exports are left over to finance the purchase of imports. The reverse is the case when export prices rise; less imports are required to pay the interest bill and more remain for the purchasing of imports. This fact is of fundamental importance in the economic welfare of New Zealand.

The volume of private debt is surprisingly large in New Zealand. At the end of the financial year in 1938 private mortgage debt alone amounted to £ N.Z. 235 million, of which £ N.Z. 105 m. was on urban properties and £ N.Z. 130 m. was on rural properties.

The volume of debt, both public as well as private has an important bearing upon employment within the Dominion. Since interest charges are fixed, a fall in prices, here, or overseas, means simply that those people who have borrowed the money have less, after meeting their debt commitments, for other purposes. They will be forced to reduce employment and probably the wage rate as well.

In conclusion the following important inferences can be made from the above brief survey.

(1) By virtue of its highly favourable climatic and soil conditions, and a large overseas market, New Zealand has developed a high degree of farming production. New Zealand, because of her scarcity of suitable raw materials, and small domestic market is relatively unsuited to large scale manufacturing. Generally we can buy most manufactured goods abroad more economically than we can produce them ourselves. New Zealand's specialisation in farming production under these conditions has enabled her to develop a high standard of living.

(2) Because of the special advantages in primary production and relative disadvantages in manufacturing, New Zealand's external trade is exceptionally high. Farm production provides the bulk of the exports, while the bulk of imports, usually manufactured of semi-manufactured goods, is obtained from the United Kingdom, which at the same time provides the principal market.

(3) New Zealand has a large public and private debt, of which a considerable portion is domociled overseas. About £ N.Z. 12 million is required annually to meet the interest charges on this debt, and this amount must be paid for out of exports receipts. This volume of debt, can prove a serious burden when overseas

prices fall, and more-over it can react unfavourably upon internal economic activities.

In considering the Labour Government's economic policy the above facts must be constantly borne in mind.

II THE ECONOMIC CONDITIONS 1935 - 36

When the new Labour Government assumed office at the end of 1935, New Zealand had just emerged from the severe economic depression of 1930 - 34, during which some important economic changes had been carried out. Some of these "recovery" measures proved to be temporary only but it is important to notice that others were adopted by the Labour Government, especially those in connection with the re-distribution of income. The more important of these changes can be broadly classified as follows:-

(1) Trade and freedom of economic enterprise were restricted not only in New Zealand but throughout the whole world. Everywhere there was a swing away from international trade to trade restrictions and economic nationalism; everywhere nations sought a way out of the depression by protecting their own industries both primary and secondary, and New Zealand was no exception.

(2) New Zealand depreciated her currency in January 1933 and effected improvements in her banking system by establishing a Reserve Bank in August 1934.

(3) A measure of re-distribution was achieved by the conversion of the internal debt at lower rates of interset, the reduction of rent and interest on mortgages and by a public finance policy involving increased taxation and increased expenditure on social services.

The economic depression was transmitted to New Zealand by a heavy fall in export prices which drastically reduced export income, despite an increas in the volume of production. In a desperate effort to maintain their incomes farmers sought to increase their output. The value of exports declined from £ N.Z. 55 m. in 1928 - 29 to £ N.Z. 35 m. in 1931 - 32; while the value of total production declined from £ N.Z. 126.6 m. to £ N.Z. 84 m. over the same period. By 1936 conditions were again approaching the 1929 level; export receipts and the value of production were rising, internal trade was expanding, factory production showed a marked increase, and bank deposits attained a record high level.

The following tables indicate clearly the extent of recovery in the economic conditions of New Zealand at the advent of the Labour Government to office in December 1935.

Exports, Imports, Value of Production and Excess Exports
£ N.Z. m.

Year	Exports	Imports	Value of Production	Excess of Exports.
1928-29	56.2	48.1	126.6	8.1
1929-30	47.0	46.5	120.9	0.5
1930-31	35.1	30.4	97.6	4.7
1931-32	36.6	24.4	83.8	12.2
1932-33	40.1	25.5	83.6	14.6
1933-34	50.1	30.4	98.8	19.7
1934-35	43.0	34.3	97.0	9.7
1935-36	53.6	39.5	114.2	14.1

From these figures it will be noticed that export income and total value of production had declined by about one third from 1928-29 to 1932-33. The exchange rate was raised from £ N.Z. 110= £ stg. 100 to £ N.Z. 125 = £ stg. 100 in 1933 in order to expand purchasing power within New Zealand. Thus by taking the value of production, less exports, plus imports, we can calculate the consummable goods available. It will be seen that this policy was more or less successful.

Goods Available for Consumption.

Year	£ N.Z. m.
1928-29	117.0
1932-33	61.2
1933-34	65.4
1934-35	88.4
1935-36	100.1

On the other hand it is true that some unemployment remained, but it was reasonable to expect that it would soon be absorbed by the wave of expanding business.

Unemployed Males.[1]
(in thousands.)

end of pt.	Unplaced or ineligible.	On Rationed Relief work.	On Sustenance Contract Work.	On subsidised Full employment.	Total from Fund.
931	7.6	43.0	---	3.9	54.5
932	6.5	45.1	---	22.0	73.6
933	4.3	44.7	---	30.2	79.4
934	3.2	32.7	5.5	23.1	64.7
935	2.5	24.1	15.5	18.1	60.3
936	2.2	13.9	25.7	7.5	49.4

In New Zealand unemployment, which follows movements of production and trade has a marked seasonal variation. It reaches the annual peak about A ugust and is lowest about March. The figures given therefore show about the worst phases of each year. The highest totals were recorded for September 1933. and by 1936 the September figure had been substantially reduced. The numbers unplaced or ineligible have also been greatly reduced and those rationed relief work (No 5 Scheme) which formerly absorbed the majority have been greatly reduced.

Just as the onset of unemployment followed a heavy fall in export prices so arise in export prices was followed by a decrease in unemployment. After 1929 export prices fell heavily and unemployment became very severe. Since 1933 prices have risen and the process has been reversed. From 1932-33 to 1936 exports increased by 68 percent, other production by 49 percent and total production by 62 percent. Both on the downward and upwards trend exports moved about a year in advance of other

1 Chamber of Commerce Bulletin, No 159, April 1938.

production. The relation shown between the columns of figures in the table on page leave little room for doubt that in New Zealand changes in export prices were the main cause both of the depression and its consequent unemployment and of the subsequent recovery. This recovery was well on the way by 1936.

Index Numbers of Wage Rates, Retail Prices and Purchasing Power of Wages.[1]

(1926-30 = 100)

Year	Wage Rates	Retail Prices	Purchasing Power of Wages.
1928	102	101	101
1929	102	101	101
1930	102	98	104
1931	94	91	104
1932	86	84	103
1933	83	79	105
1934	84	81	104
1935	86	84	103
1936	95	86	110

These figures indicate how, during the depression period wages fell less rapidly than prices and the purchasing power of wages increased. As recovery followed, up to the end of 1935, wage rates rose but prices tended to increase more rapidly and some of the increased purchasing power of wages was lost. The increases both in wage rates and in purchasing power wad largely due to the changed conditions under the legislation enacted early in 1936.

1 op cit No 151, August 1937.

III. MONETARY CONDITIONS 1935-36

By far the most important features of the monetary situation, in the light of subsequent events, were the position of the Reserve Bank and the accumulation of London Funds.

The introduction of central banking in New Zealand caused considerable changes in the structure of the banking system. The gold reserves of the trading banks were transferred to the Reserve Bank; the trading banks surrendered their right of note issue; the greater part of the Government bank deposits formerly held by the Banks of New Zealand were transferred to the Reserve Bank and in addition the trading banks had to place minimum deposits with the Reserve Bank. Large transfers of exchange funds were also carried out. Some £20 stg.m. of London funds held by the Government were transferred to the Reserve Bank and were used to pay off a corresponding large amount of Treasury bills held by the trading banks. The Reserve Bank thus commenced with considerable holdings of sterling.

The position of the trading banks was also very healthy. Bank deposits in New Zealand were large, advances small and the holdings of London funds exceptionally large. Hence the transfer involved no strain on the money and credit system and apart from the change in note issue, there was no apparent change in the working of the system.

When the Reserve Bank opened for business it announced that it would buy and sell sterling exchange at £ N.Z. 125 and £ N.Z. 124 per £ stg 100 respectively, and it was anticipated that these rates would remain unchanged for a considerable time. This announcement had the effect of stablising the exchange. The Bank announced also that its discount rate would be at four percent, but this was subsequently reduced to two percent. During the first two years of its operations, the Bank made neither advances nor discounts. It was concerned with managing the note issue, holding Government and trading bank deposits together with some other small deposits; it maintained a gold reserve of £ N.Z. 2.8 m. and held large funds in sterling. This was a period of abundant money, low interest rates and steady expansion.

Trading Bank Deposits aand Advances.
£ N.Z.m.

Year	Deposits.	Advances.	Excess Deposits.
1929	55.02	53.81	1.21
1930	53.24	54.38	1.14
1931	51.99	51.02	0.97
1932	51.92	50.24	1.68
1933	59.28	43.76	15.52
1934	61.52	42.45	17.07
1935	61.79	46.35	14.86

The figures give a good indication of the banking situation up to the beginning of Labour A dministration, The expansion of deposits was almost £ N.Z. 10 m since 1932 and the contraction in advances was almost £ N.Z. 4 m. Depostits stood at record high levels while the excess of deposits over advances was also very high.

Budget Results.
£ N.Z. m.

Year	Taxation	Other Receipts.	Total Revenue.	Expenditure.	Surplus+ Deficit-
1928-29	17.83	5.77	23.60	24.18	-0.58
1932-33	15.61	6.99[1]	22.57	22.53	+0.04
1935-36	21.56	4.61	26.17	25.89	+0.28

1 including £ N.Z. 2m from reserves.

These figures show that, excluding employment taxation which is not included in the Budget, tax revenue had increased substantially since 1932-33, the lowest mark of the depression. Total expenditure had also expanded with revenue, exceeding the pre-depression level.

The total amount of London funds at the end of 1935 was exceptionally large, this figure being approximately £N.Z.40 m.

During the depression severe measures were undertaken to secure budget equilibrium. They included the cessation of overseas borrowing, drastic cuts in salaries and wages and an increased scale of taxation. But by the time the new Labour Government had assumed office at the end of 1935, economic recovery was well on the way; budget revenue was bouyant, the taxation yield had increased and the Government could confidently expect a further increase in the taxation yield in the future. Although recovery had largely been achieved and the monetary situation placed on a sound basis as shown by the accumulation of London funds (£ stg.46.6.m. in May 1935), there still remained some outstanding problems requiring solution. For instance, although unemployment had been reduced from 73.6 thousand to 60.3 thousand at the end of September 1935, this problem was still serious.

In addition large loans were due to mature in Great Britain in the not distant future. The plight of the small farmers, and in particular the small dairy farmers was still serious..

Much of public policy would therefore be conditioned by whatever method would be adopted to cope with the problem of unemployment. Two courses were open to the Government: first to allow unemployment to be absorbed by the expanding wave of business or secondly to absorb them directly into State undertakings such as Public Works. The Labour Government chose the latter method. The excess of London funds was to prove a factor of first importance in that it made possible a policy of internal business expansion.

CHAPTER IV

MONETARY POLICY.

I <u>The Reserve Bank of N.Z. Amendment Act 1936.</u>

As stated earlier Labour has always placed its monetary and financial policy in the forefront of its programme. From time to time statements by Government members and others, have been made concerning the utilisation of "public credit", "costless credit", and such delightfully vague phrases as "money power for the people," and the like. Vague as these terms maybe, yet in actual practice they meant nothing more nor less than the complete state ownership and control of the Reserve Bank. Accordingly the first major legislation of the new Government was the Reserve Bank of New Zealand Amendment Act of April 1936, which which placed the Bank at the disposal of the State. This amendment defined the functions of the Bank as follows:

"It shall be the general function of the Reserve Bank within the limits of its powers, to give effect as far as maybe to the monetary policy of the Government, as communicated to it from time to time by the Minister of Finance. For this purpose and to the end that the economic and social welfare of New Zealand may be promoted and maintained, the Bank shall regulate and control credit and currency in New Zealand, the transfer of moneys to or from New Zealand, and the disposals of moneys that are derived from the sale of any New Zealand products and for the time being as are held overseas."

This amending Act brought the Reserve Bank under complete State ownership and control. The share capital of the Bank was paid off, share-holders receiving £N.Z.6/5/- for each £N.Z.5 share held. The capital item of £N.Z. ½ million disappeared from the balance sheet but the general reserve was supplemented by this amount. The number of Directors remained unchanged but all these now became State appointed, and held office at the pleasure of the Minister of Finance. The Secretary of the Treasury was given power to vote. In addition the Bank's power to lend was greatly extended. The Bank was empowered to make advances to the Government or to any authority having statutory powers in respect to the marketing of New Zealand produce, to underwrite loans to the Government of State Advances Corporation and to issue and manage loans for the Government or local bodies. Finally the limit of one half year's revenue placed on the total amount of Treasury Bills that could be discounted for the Government was extended to the full revenue of the Government for one year.

It will be seen from the above brief analysis of the changed status of the Reserve Bank that the Labour Government were now in a position to use the Reserve Bank as an instrument of their policy. Advances from the Bank could be utilised in various ways: for housing, through the State Advances Corporation or otherwise; for public works, and in fact it could make loans for the development of any industry at present being operated in New Zealand, or for the establishment of any new industries in New Zealand, (such as the projected Iron and Steel works.)

In the words of the late Prime Minister the purpose of the new banking legislation was:-

"All we want is to use the public credit to develop New Zealand; it does not matter whether we borrow money or issue money through our own credit institutions, the same thing applies. The public credit is pledged, and the productive power of the people must be the foundation of it in the long run."[1]

But during the first two and a half years of its regime the Government was able to operate on relatively orthodox lines

1 Rt.Hon. M.J.Savage, "N.Z. Parliamentary Debates." Vol 244 p 157

and was saved from resort to credit creation through the machinery of the Reserve Bank, by the bouyant state of public finance. This was mainly the result of rising export prices and expanding export receipts.

(II) BUDGET POLICY.

During the period under review the Government presented four budgets. Each year has shown progressive increase in expenditure from current revenue but only twice during this period was it found necessary to alter the rates of taxation. In 1936 income taxes were increased on higher incomes and a graduated land tax was also introduced. In 1939 further increases were made in income tax, petrol tax, beer duty tax and death duties. The Government was favoured with bouyant export prices over the early period of office and these were reflected in the budget results as shown in the following tables.

Budget Results.
£ N.Z.m.

March	Taxation	Other Receipts.	Total Revenue.	Expenditure.	surplus.
1935-36	21.56	4.61	26.17	25.89	.28
1936-37	26.94	4.21	31.15	30.68	.47
1937-38	31.66	4.40	36.06	35.25	.81
1938-39	32.30	4.28	36.58	35.77	.81

The outstanding feature of these figures is the healthy increase of £ N.Z. 10 m in the yield of taxation between 1935-36 and 1937-38. Marked increases in taxation yields occurred in the returns from Customs, Sales, Motor Vehicle and Income Taxation as will be shown in the next table.

Taxation Yield (Consolidated Fund.)

Items	1935-36	1936-37	1937-38	1938-39
Customs	8.16	9.50	10.76	10.65
Beer Duty	.71	.84	.98	1.08
Motor Taxation	2.12	2.50	2.84	3.60
Land Tax	.46	1.05	1.04	1.06
Income Tax	4.58	6.62	9.08	9.30
Stamp & Death Duties	2.84	3.16	3.28	3.26
Film Hire Tax	.06	.07	.08	.09
Sales Tax	2.46	3.04	3.50	3.56
Gold Export Duty	.11	.11	.10	.10
	21.50	26.89	31.66	32.30

In addition these figures show that the proportion of indirect taxation to total taxation was high; it constituted 54 percent of the total in 1937-38. The level of taxation is high compared with the level of internal economic activity, but it is important to note that this ratio is increasing. In 1935-36, the ratio of taxation to the value of production was 18.8 percent, in 1939 was 22.5 percent. It will be noticed too that the greater portion of Government revenue is derived from taxation. In 1938-39 total revenue amounted to £ N.Z. 36.58 million, of which £ N.Z. 32.30 million came from taxation. But this high level of taxation can be maintained only so long as there is a high national income to support it, and the national income is largely dependent upon export prices. If these fall, and there is nothing that the Government can do to prevent their falling, then the taxation yield must fall as well.

The above table does not include the taxation from the Unemployment Promotion Fund. This account is presented separately. The figures for this Fund are as follows.

£ N.Z. m.

March.	Revenue.	Expenditure.
1935-36	3.92	4.88
1936-37	4.26	4.41
1937-38	5.14	4.24
1938-39	5.52	6.47

This fund was instituted during the depression as an emergency measure. The present Government utilised the funds to provide sustenance, unemployed relief, and other employment. But in 1939 the introduction of the Social Security Scheme placed a dditional strain upon this Fund. It was consequently abolished and its revenue transferred to the Social Security Fund.

There are two serious failings to be found in the practice of taxation in New Zealand. Though these are distinct they are nevertheless connected. First the amount of taxation required is higher than can be safely collected by the methods adopted. Secondly the methods of collection together with the nature and incidence of the taxes are in many cases such as to defeat the ends which taxation is designed to serve. The present Government did not create this tax system. It is a product of Government policy over a long period of years which has been shaped not by reference to theoritical principles of taxation, but by the urgent necessity of obtaining revenue for the ever increasing amount of state expenditure. This Government has merely extended the traditional system of taxation in order to provide funds for its expansionist economic policy.

An analysis of the main items of Government expenditure will make this point clear. The main channels of Government expenditure are the consolidated Fund, Public Works Fund, Electricity Supply Account, Employment Promotion Fund (and now the Social Security Fund) Main Highways Account and Housing Department Account. Of these channels, the most important is the Consolidated Fund. The following table gives a summary of payments from the fund.

Payments from the Consolidated Fund.
(£ N.Z. m)

Items.	1935-36	1936-37	1937-38	1938-39
Debt Services & Exchange	10.94	10.96	11.28	10.73
Highways	2.11	2.49	2.81	3.03
Other permanent appropriations	.74	.64	1.53	.57
Pensions	3.77	5.07	6.47	6.93
Education	2.79	3.40	3.68	4.10
Departmental etc.	5.54	8.12	9.48	10.41
Total.	25.89	30.68	35.25	35.77

From this analysis it will be noticed that the first item showed an increase up to 1938 and then declined. The funds for financing it are derived from taxation and are therefore not likely to increase unless there is a phenomenal rise in export prices.

The highways item which shows an increase in this table is self balancing. It is financed from the proceeds of motor taxation. As will be shown in the chapter on Transport a considerable portion of the revenue derived from this source has been utilised for purposes other than road maintenance.

The last three items in the table show a substantial increase. This is due to two main causes. First the spectacular expansion of Social Services and secondly the expansion of employment in Government departments and the improved working conditions. These points will be elaborated in subsequent chapters, especially those dealing with Social Services and Labour Policy.

(III) CAPITAL EXPENDITURE.

It would be of considerable assistance to have acess to a clear cut statement of the Government's public works policy, the nature of the works to be undertaken and the amount and sources of money to be spent. But the Government does not publish such a statement. Estimates of public works are made available each year with the publication of the budget but the payments and receipts are scattered over the various avenues of Government expenditure which were listed in the above section. To a certain extent this confusion and lack of definite statement of policy may be attributed to the fact that the main objective of the Labour Government was to create employment for the large body of unemployed males in existence in New Zealand in 1935, and to provide a reasonable standard of living for the mass of the people. That the existence of this body of unemployed warranted some action by the new Government there can be no doubt. But in endeavouring to cope with this problem the Government most certainly overlooked the dangers inherent in a bold expansionist public works policy of unproductive undertakings.

While a feature of financial policy during the first two years of Labour's administration has been the increased use of current revenue to assist financing public works, the major portion of this programme has been financed by loans from various sources.

The expenditure on public works for the years 1936-36 to 1939-40 is as follows.

Public Works Expenditure.

Year	£ N.Z.m.
1936-37	13.46
1937-38	17.11
1938-39	24.72
1939-40	27.00 (est.)

These amounts were used to finance such undertakings as Public Works including railways, buildings, roads and highways, land development, electrical supply and other facilities. This programme necessitated heavy expenditure on machinery and equipment. It will be seen that much of this expenditure was unproductive in that only the amounts spent on hydro-electricity schemes, telephone and telegraph would be likely to its own interest bill. Such unproductive expenditure is a serious weakness in the Public Works Policy of New Zealand. While the costs of the railways, including interest, were well in excess of the revenue, large sums were being spent annually on new railway construction.

It is interesting to notice that it was not found necessary to appeal directly to the public for loan funds until 1939. This was due to two factors. First the Government was able to finance its capital expenditure from revenue and from loans raised from Departmental sources, the chief of which was the Post Office Savings Bank. Secondly the Government was able to utilise Reserve Bank credit, especially after the middle of 1938, to repay Post Office deposits, to finance the new Housing scheme and maintain its volume of capital expenditure. The implications of this policy of financing state undertakings will be dealt with more fully in the chapter on Import and Exchange Control.

(IV) INTERNAL BORROWING.

This has already been mentioned in the preceeding section but it will be necessary to treat internal borrowing separately as it constituted an important part of the Government's monetary policy. The Government took a serious view of the problem of the interest burden in New Zealand, and appeared to overlook the real advantages which had accrued from overseas borrowing in the past, in relation to the continuing burden of interest. Consequently, it advocated a policy of cessation of overseas borrowing and undertook to repay loans as opportunity offered. But while the Government made public its denunciation of overseas borrowing it apparently sanctioned a policy of internal borrowing.

Until 1939 when the Government was obliged to appeal directly to the public for loan funds, internal borrowing took the form of loans from various Departments. Of these, the Post Office Savings Bank was the most important source of loan funds. From 1935 to 1938 deposits with the Post Office Savings Bank registered a substantial total increase owing to the excess of deposits over withdrawals. While one reason for this increase may have been the lack of suitable openings for investments within New Zealand, an important result was that this increase of deposits provided the Government with a source of funds from which it could readily borrow.

The following table shows movements of deposits and withdrawals of the Post Office Savings Bank.

Post Office Savings Bank Deposits and Withdrawals.
£ N.Z.m.

Year	Total Deposits.	Total Withdrawals.	Difference.
1935-36	25.62	23.53	+ 2.09
1936-37	30.67	27.04	+ 3.63
1937-38	33.04	29.63	+ 3.41
1938-39	30.43	34.59	- 4.16

From about the middle of 1938 an adverse movement set in, resulting in an excess of withdrawals over deposits to the extent of £ N.Z. 4.16 m. This was serious for the Government from two points of view. First it had to find another source of loanable funds in order to finance its expansionist policy and secondly it had to secure funds from other sources to repay its loans to the Post Office Savings Bank. To cope with this situation the Government resorted to the use of Reserve Bank credit. It is no mere coincident that when the source of loanable departmental funds began to dry up, the Reserve Bank holdings of Treasury Bills showed a substantial increase. In February 1939 the total issues of Treasury Bills to the Reserve Bank was in excess of £ N.Z.12 million, and it has since increased. In March 1939, the Government appealed to the public for a loan of £ N.Z. 4 million.

By March 1939, the Government had reduced overseas loans by £ N.Z. 2.56 m, while it increased the internal debt by £ N.Z. 23.98 million.

Thus up to the middle of 1938 the Government had been able to conduct its monetary policy on relatively orthodox k lines. This date marks a radical change of monetary policy. From then onwards the Government began to utilise to an increasing extent its powers of obtaining credit from the Reserve Bank. This was made possible by the changed status of the Reserve Bank under the Reserve Bank Amendment Act of April 1936.

(V) CREDIT CREATION.

From August 1936, when the Government took over the marketing of dairy produce, it had been borrowing from the Reserve Bank against dairy produce exported. These advances were repaid as the produce was sold and the proceeds became available. Such advances were not inflationary; they represented merely a transfer of business from the trading banks, which had formerly made similar advances, to the Reserve Bank. In addition the Government had borrowed moderate amounts from time to time from the Reserve Bank, but these advances had all been repaid and up to May 1938 none were outstanding.

From June to December 1938, "other" advances to the State, for Public Works, Housing, Marketing and the like registered a substantial increase. At the end of the year the figure stood at £ N.Z.11.2 million. In addition the Reserve Bank's investments increased and also the trading banks holdings of Government securities increased considerably. This meant a credit expansion of £ N.Z. 15.67 million on Government account.

One result of this internal credit expansion consequent upon the expansionist policy of the Government was a depletion of net overseas assets. This will be treated more fully in a subsequent chapter on Import and Exchange Control.

An analysis of the published bank returns reveals the extent of credit expansion in New Zealand during the two years 1938 and 1939. In the following tables[1] comparisons are made of the bank returns at the end of 1937 and 1939. The first table compares the returns of the Reserve Bank and shows the extent to which the Reserve Bank has been utilised for credit creation in the years 1938 and 1939.

Reserve Bank Returns.
(£ N.Z.m.)

End of December.	1937	1939	Difference.
Notes issued.	15.23	19.29	+ 4.06
Deposits:			
State	3.49	2.86	- .63
Trading Banks	8.93	13.54	+ 4.61
Other	.50	.03	- .47
Other Liabilities	.17	.78	+ .61
Advances to State	7.08	22.66	+15.58
Exchange	16.99	8.70	- 8.29
Investments	2.66	3.36	+ .70
Other assets	.28	.41	+ .21

These items balance as follows.

The Bank provided.	£ N.Z.m.
By reduction in State deposits.	.63
" Reduction in "other deposits"	.47
" Increase in advances to State	15.58
" Increase in investments	.70
" Increase in other assets	.21
Total	17.59

1 The tables in this section have been adapted from a publication by Professor A.H.Tocker, entitled "Monetary Experiment in New Zealand." 28/2/40

The Banks customers used this increase.	£ N.Z.m
To Increase note issue	4.06
" Increase Trading Bank deposits at Reserve Bank.	4.61
" Purchase exchange from Reserve Bank	8.29
" Increase other liabilities of the Bank	.61
Total	17.57

It will be noticed from these figures that the Bank provided £ N.Z. 17.59 m. of which £ N.Z. 15.58 m represented increases in advances to the State, and a further £ N.Z. 1.33 m was covered by reductions in State deposits and increases in the Bank's investments. The total amount provided £ N.Z.17.59m was spent in various ways. Part of this amount was used to purchase exchange from the Reserve Bank on Government account, and the remainder on State enterprises in New Zealand, mainly Public works. This would expand the circulating money in the country and would ultimately be disposed of in some way by the public into whose hands it fell. Since most of it would pass through the trading banks some changes would be likely in the Trading bank figures. By December 1939 the sum of £ N.Z.4.06m had been used to purchase extra note issue from the Reserve Bank; £ N.Z. 4.61 m to increase the trading bank deposits at the Reserve Bank; £ N.Z. 8.29 m to purchase exchange from the Reserve Bank, and £ N.Z. .61 m to increase other liabilities of the Bank. These facts leave little doubt that the addition credit created by advances to the State place a substantial increase of purchasing power in the hands of the Government and the community. This increase was reflected in an increase in imports and an export of capital from New Zealand, the combined effect of which was to bring about a serious depletion of net overseas assets.

But credit expansion went further than this. The facilities of the trading banks were used as well. One result of the credit created by the Reserve Bank was an increase in trading bank resoures. With the introduction of import and exchange control, the trading bank's advances to customers declined, thus enabling these banks to take up additional securities to the extent of £ N.Z. 7.42 m within New Zealand, thereby further expanding credit to this extent. In addition the trading banks made available £ N.Z. 2.15 m of their own capital and reserves not formerly used in New Zealand. This further expanded credit within New Zealand. The figures for the trading bank returns during this period are as follows.

Trading Bank Returns.
(£ N.Z.m)

End of December	1937	1939	Differences.
Capital used	17.98	20.13	+ 2.15
Total Deposits	65.67	73.21	+ 7.54
At Reserve Bank	8.92	13.54	+ 4.62
Notes and Coin	4.23	4.26	+ .03
Discounts and Advances	54.00	51.14	- 2.86
Net securities held	6.66	7.11	+ .45
Securities	8.04	15.46	+ 7.42
Premises	1.78	1.83	+ .05

These items balance as follows:

	£ N.Z.m
Increases in resources.	
Increases in capital used	2.15
Increases in customers deposits	7.54
Admances repaid by customers	2.86
	12.55
These increases were used.	
To Increase Trading bank deposits at Reserve Bank	4.62
" Increase holdings of notes and coin	.03
" Increase holding of securities.	7.42
" Increase holdings of Exchange	.45
" Increased premises	.05
	12.57

These figures reveal an increase of £ N.Z. 12.55 in trading bank resources during the years 1938 and 1939. Of this total the biggest increase was in customers deposits, namely £N.Z.7.54m. This was largely the result of the credit created by the Reserve Bank and spent by the Government in New Zealand. It coincides almost exactly with the trading banks increased investment in Government securities which amounted to £N.Z.7.42m. Other items contributing to the increased resources of the trading banks were £N.Z.2.15m. of bank capital and reserves made available in New Zealand, £N.Z.2.86m. increase of deposits repaid by customers. The trading banks used their increased resources to increase their deposits at the Reserve Bank by £N.Z.4.62m.,to increase their holdings of notes and coin by £N.Z. .03m., to increase investments by £N.Z.7.42m., to increase overseas exchange by £N.Z..45m.and their premises by £N.Z..05m.

The combination of the above two tables will show the effects of the credit expansion on the banking system as a whole.

Combined Bank Returns.
(£ N.Z.m.)

End of December.	1937	1939	Difference.
Trading bank capital used.	17.98	20.13	+2.15
Total Deposits.	69.16	76.07	+6.91
Notes in circulation.	11.68	15.63	+3.95
Exchange funds.	23.65	15.81	-7.85
Advances (Trading Bank)	54.00	51.14	-2.86
Advances to Government (Reserve Bank)	7.08	22.66	+15.58
Investments and Securities.	10.70	18.82	+8.12

These items balance as follows:

Additional Credit made available.	£N.Z.m.
By Advances to Government from Reserve Bank.	15.58
By Increase Bank investments and securities.	8.12
Total for Government.	23.70
Less decrease in trading bank advances.	2.86
Net addition.	20.84

How this addition was used:	
For Increased trading bank capital.	2.15
For Increase in note circulation.	3.95
For Increased deposits at bank.	6.91
For Purchase of exchange.	7.84
Total.	20.85

An examination of this table shows that the total additional credit made available on Government account was £N.Z.23.70m., including £N.Z.15.58m.increases in advances to the Government from the Reserve Bank,and £N.Z.8.12m. representing increases in the investments and securities held by the Reserve Bank and trading banks combined. A decrease of £N.Z.2.86m. in trading bank advances to customers reduces this total to £N.Z.20.84m. This amount was spent by the Government and the public of New Zealand. This total was utilised in various ways:£N.Z.2.15m. had to be paid for the use of the increased trading bank capital made available; £.N.Z.3.95m. was used for increased note circulation;£N.Z.6.91m. represented increased customers deposits at the banks and finally £.N.Z.7.84m. was spent on purchasing exchange from the banks, thus reducing their overseas funds.

Thus, of the total credit created only £7.84m. plus £N.Z. 2.15m. of trading bank capital was used during 1938 and 1939 to purchase overseas funds, while approximately £N.Z.11m. was added to the amount of money available within New Zealand. This means that there is substantially more money available in New Zealand and less available for purchase of overseas funds as a result of the expansion of credit. The progress of credit expansion during the period under review is worthy of consideration. The following table shows the totals of advances and securities held by the Reserve Bank and the trading banks, both separately and combined.

Gross Expansion of Credit.
(£ N.Z.m.)

[E]nd of	Reserve Advances to State	Bank. Investments	Trading Bank. Govt. Securities.	Total.	Difference from end of 1937.
[1]937 Dec.	7.08	2.66	7.76	17.50	-
[1]938 March.	5.31	2.97	7.63	15.91	-1.59
June.	4.76	2.73	6.72	14.21	-3.29
Sept.	7.66	2.73	8.26	18.65	+1.15
Dec.	16.46	3.60	8.76	28.82	+11.32
[1]939 March.	19.43	3.66	10.06	33.15	+15.65
June.	16.93	3.77	10.61	31.31	+13.81
Sept.	20.84	3.82	10.49	35.15	+17.65
Dec.	22.66	3.36	15.20	41.22	+23.72

This table shows all the advances made to the State, including those for marketing and dairy produce, and the trading bank securities are Government securities alone. In the last column a decrease is registered in credit expansion, but this is due to seasonal variations and is a feature common to New Zealand's economic history. Allowing for further seasonal variations in June 1939, the trend of credit expansion has been progressively upwards since June 1938. This table gives the gross expansion of credit, and in order to obtain the net expansion of credit the advances to customers and the Reserve Bank's discounts must subtracted from it. The net expansion of credit, as shown above was about £N.Z.20.84m.of which approximately £N.Z.11m. was added to the amount of money available within New Zealand.

Subsequent events have shown that the first direct effect of the Government's policy of using Reserve Bank credit in New Zealand was to promote an expansion of credit unaccompanied by a similar expansion in the goods and services on which that money was spent. While exchange remained unrestricted the effects of the additional purchasing power so created, were reflected in the purchase of overseas funds and ultimately in the depletion of net overseas assets. With the introduction of exchange control however, this additional credit was no longer free to leave the country and consequently the creation of this excess credit unbacked by saleable goods was likely to produce rising prices and depreciation of the purchasing power of money within New Zealand.

(VI) GENERAL REMARKS.

The brief survey in the preceeding sections of this chapter of the monetary policy of the Labour Government during its first four years of office shows that this policy falls conveniently into two distinct stages, namely a period of relative orthodox monetary policy and secondly a period of credit creation through the machinery of the Reserve Bank. Apart from the fact that the Government had superimposed an extensive programme of public works, mainly of an unproductive nature, on a boom period in the trade cycle, their policy during the first period calls for little further comment. The motive behind this policy was of course the reduction of unemployment. The effect of the policy was however most important, as it increased internal purchasing power to such an extent that the demand for imports increased rapidly. Increased imports meant a corresponding decrease in overseas funds. It was the excess credit created, unbacked by saleable goods, that placed in the hands of the community the means to purchase from the banks the overseas funds required to pay for imports. In this way the Government's policy is directly responsible for many of the Dominion's present difficulties.

It was the continuance of this expansionist policy, especially the extensive public works programme, which forced upon the Government the alternative of a radical change of policy, or of resort to credit creation through the machinery of the Reserve Bank. The Government naturally chose to continue with its former policy and proceeded to finance it directly with advances from the Reserve Bank. This action hastened the depletion of London funds and forced the Government to take action towards the end of 1938. Credit creation continued, even after the imposition of import and exchange control. Consequently the additional money remained in New Zealand and caused prices to rise and the purchasing power of money to depreciate. In other words the effects of credit creation began to work out within New Zealand and not on the foreign exchange. It would accentuate the difficulties of the Government's policy of internal stabilisation.

Broadly conceived the Government's monetary policy, especially that of credit creation, is an experiment of first importance, and there are certain lessons to be learned from it. A comment by Professor A.H.Tocker in an article "Monetary Experiment in New Zealand" best sums up the position in regard to monetary policy in New Zealand.

> "It should now be obvious that in the long run we can consume only to the extent that we produce;that whatever the Government spends the people must pay for;and that the purchasing power of the people is limited by the goods and services produced and marketed, and is not increased by an increase of money. All this means that no monetary manipulation can enable us to escape the fundamental fact that we must live within our income, and limit our consumption to the value of our production. If these lessons are learned, then the experiment may not have been wholly in vain, and the knowledge gained may yet prove reasonably cheap at the price."

CHAPTER V

MARKETING.

I Guaranteed Prices.

II Internal Marketing.

III Wheat Control.

(I) GUARANTEED PRICES.

Because of the vital importance of farming in the economic life of New Zealand, a great deal of effort on the part of this Government (as well as previous Governments) has been directed to improving the position of farming industries. Accordingly one of the major proposals of the Labour Government was to guarantee to the farmer the price of his products. Writing in his pamphlet,"Guaranteed Prices,Why and How?" Mr.Walter Nash stated: "The Labour Party undertakes to institute the guaranteed procedure and to pay the agreed upon price for all butter,cheese, wool and meat, during the first year after it becomes the Government." In May 1936 the Primary Products Marketing Act was enacted, and the guaranteed price procedure was applied to all dairy produce. Meat and wool had evidently to stand aside in the meantime.

The preamble to the Act declared that its purpose is to make "better provision for the marketing of dairy produce and other primary products, so as to ensure for producers an adequate remuneration for the services rendered by them to the community." The preamble also emphasises the necessity for protecting primary producers from the effects of fluctuations in market prices and that such protection can most effectively be afforded by empowering the Government to assume ownership of products for export at prices to be fixed from time to time, and by acquiring ownership at fixed prices of products intended for local consumption. Further the Act was designed to ensure to the efficient farmer, operating under "usual" conditions and in "normal" circumstances, an income which shall be stable, fair and in relation to the services rendered. It aimed also to provide the farmer with a "reasonable" standard of living, comparable with that of the rest of the community.

The new legislation empowered the Government to create a Primary Products Marketing Department, under the control of the Minister of Marketing. The functions of the Department were to acquire primary products on behalf of the Government and to market those products overseas whether these have been acquired by the Government or not. It was also the function of the Department to arrange for transport of the produce to the market. The activities of the Department were in the first instance confined to dairy produce, which became the property of the Government when placed on board ship, at a price determined in advance by order-in-Council.

The Department took over the existing system of marketing and effected certain important changes in the direction of a further extension of control. It proposed to replace the former Export Produce Control Boards, but up to the out-break of the present war with Germany it had taken over the functions of the Dairy Export Control Board only. Single state ownership was substituted for the previous system of multiple ownership by different producing factories. It improved the existing system of distribution and supervision. The Department selected twenty-two importing houses to act as their selling agents in the United Kingdom for the purpose of :-

(1) Securing the services of sales organisations which would provide the maximum regular distribution of New Zealand dairy produce to the various wholesale, retail and manufacturing interests.

(2) Retaining those importing houses which would be most likely to co-operate with the Department for the purpose of eliminating unregulated selling competition.

(3) Creating a minimum disturbance of the existing distributive methods.

The Department has greatly improved the external marketing of dairy produce;it has eliminated to a large extent speculation and irregularity of supplies to the market, and it effected a reduction in selling costs of approximately £stg.100,000,during the first year of operation.

The procedure for fixing prices for dairy produce has proved difficult and unpopular with the farming community. The prices for the 1936-37 season were based on the estimated average prices for the previous 8 -10 years, and from then onwards were to be determined by orders-in-Council in accordance with the following five principles of the Act.

(1) "The necessity in the public interest of maintaining the stability and efficiency of the dairy industry.

(2) The costs involved in the efficient production of dairy produce.

(3) The general standard of living of persons engaged in the dairy industry in comparison with the general standard of living throughout New Zealand.

(4) The estimated cost to the Department of Marketing of the dairy produce concerned, and also the cost of the general administration of the Act.

(5) Any other matters deemed to be relevant."

To assist it work the task of determining prices for dairy produce the Government set up an expert Advisory Committee. No information of the report of the Committee was made public. The following average prices were used as a basis.

Purchase Prices of Produce.
Shillings per cwt.(F.O.B.)

Average Period of years.	Creamery Butter.	Cheese.	Whey Butter.
8	109/4	56/6	99/4
9	112/2	57/1	101/2
10	114/-	58/6	104/-

Corresponding Butterfat Pay Out.
(Pence Per lb.)

Average Period of years.	Creamery Butter.	Cheese.	Cheese including Butter Whey.
8	12.11	12.66	13.21
9	12.37	12.83	13.39
10	12.73	13.23	13.81

The Government decided to fix a price which would equal the pay-out of the best average period. It was decided to fix the price of butterfat at 129/16d per pound and 6.13/16d per pound for cheese, with variations for quality. It was estimated that the pay-out for butter-fat would be 13.529d per pound and 14.440d per pound of butterfat for cheese.

As might be expected farmers expressed dissatisfaction with these prices. They wanted more. They complained that the Report was not made public; they urged the creation of an independent tribunal, something along the lines of the Arbitration Court; they were disappointed that there was no right of appeal against the decision of the Government's determined prices. The Primary Products Marketing Department later made its report public.

In determining the prices for the 1937-38 season the Government set up a Guaranteed Price Advisory Committee. This Committee analysed 19,000 completed returns which had been prepared by the Statistics Department. On the basis of this investigation the prices determined by the Government showed an increase on those of the previous season. The price for butter was to be 13¼d per pound and 7.54d per pound for cheese. This was estimated to yield 13.88d per pound of butterfat for butter and 15.88d per pound of butterfat for cheese.

But again the farming community protested. They rightly claimed that the increased prices did not compensate them for the increased costs, which were due largely to the Government's own expansive economic policy, which was manifest in rising money wages, improved working conditions of labour, rising public expenditure and the resort to Reserve Bank Credit for State undertakings. The Report of the Department published in 1937 had stated:

"The history of the dairy industry shows clearly that high prices do not necessarily promote stability of the industry, because of the tendency to capitalise the benefits in inflated land and stock values. The guaranteed price should not be such as will induce persons to capitalise its benefits, especially as the trend of land and stock prices in 1936-37 was of a hardening nature."

It would seem that in revising the 1936-37 prices, the Government had been obliged to make some allowance for the increase in the costs of production, but on the other hand had attempted to keep the price down in order to avoid too large a deficit in the dairy industry account. It was clear to the Government and others concerned that a series of heavy deficits would inevitably wreck the entire guaranteed price scheme.

Strong recommendations from the farming community to alter the method of price determination resulted in the Government setting up yet another advisory committee to fix the prices for the 1938-39 season. The committee recommended an increase in prices over the previous season, from 13.66d per pound to 15.605d perpound for butter and from 7.75d per pound to 8.775d per pound of cheese. After considering these recommendations the Government fixed prices at a lower rate for both cheese and butter. The Committee and the Government evidently differed in their interpretations of the terms "efficient producer," "usual conditions," "normal circumstances," and "average cow."

The following table will illustrate how the different interpretations of these terms resulted in difference of opinion of the Committee and the Government as to what the prices for butter and cheese ought to be.

	Committee's Decision.	Government's Decision.
Butter fat per acre	100-175 lbs per year.	100-175 lbs per year.
Butter fat per full time male labourer employed.	5750 lbs per year	6000 lbs per year
Butter fat per cow	220-250 lbs per year	250 lbs peryear
Capitalisation (rate per cow)	£75	£75
Capital Charges (interest per lb of butterfat)	3.375d	3.24d
Working & maintenance costs, per lb butter fat.	5.695d	5.34d
Standard of Pig returns.	1.54d	1.54d
Dairy Factory costs per lb of butterfat.	3.50d	3.50d
Labour reward per lb of butterfat.	9.220d	8.84d
Allowance for Housing etc. per week.	£1-10-0	£1-10-0
Labour Reward: farmer per week	£4-10-0	£4-10-0
Labour Reward: hired labour per wk.	£4- 0-0	£4- 0-0

It will be noticed that in respect to the butter fat per full time male labourer employed, and the butter fat per cow, the estimates of the Government were higher than those of the Committee, while the working and maintenance estimates were lower. The Government claimed that the Committee did not give full consideration to the central feature of the scheme, namely the aim of achieving stabilisation of the dairying industry. The Report of the Department in 1938 state that

"the allowance for working and maintenance costs are on such a scale that if they are expended for the purposes specified, only an inefficient farmer working under unusual conditions or in abnormal circumstances, could fail to attain the average of the per cow, per acre, per man standards mentioned"[1]

Moreover the Government maintained that it had set up the Committee in an advisory capacity only; it was free to modify the Committee's recommendations if it considered it in the interests of the community to do so. There can be little reason for doubt, however, that the Government decided to fix prices lower than those recommended by the Committee in an endeavour to avoid an unduly large deficit in the dairying account. Any increase in the prices paid would merely accentuate the already ascending spiral of costs and prices. Unless the Government was determined to avoid large deficits in this account and so preserve the guaranteed procedure, it is difficult to see that it had any alternative but to fix the prices as low as possible.

Although it may be economically desirable to stabilise the income of the dairy farmers, it is politically impracticable

1 Primary Products Marketing Report 1938 p 6

to do so. Either the Government had to submit to pressure and run the risk of deficits in the account, which if continued long enough would wreck the guaranteed scheme, or it had to resist pressure and run the risk of antagonising the farming electorates. It is significant that just prior to the 1938 elections the Government deemed it expedient to pay the dairy producers a bonus!

To finance the guaranteed prices for dairy produce the Dairy Industry Account was established at the Reserve Bank. All export receipts of dairy produce are paid either directly or indirectly into this account and all payments in respect to the Dairy Industry, the guaranteed prices, costs of marketing and costs of administration are paid out of this account. Any deficits, whether seasonal or totherwise are to be met by overdraft from the Reserve Bank, without limit or without conditions as to repayment. This account was later incorporated in the Primary Products Marketing Account and covers transactions other than those arising from the export of dairy produce. But transactions relating to the export of dairy produce comprise by far the most important items in the account.

The deficits of this account up to July 1939 were as follows;

£ N.Z. m.		
Year	Minimum	Maximum.
1936	1.095	6.060
1937	3.766	6.560
1938	3.159	5.257
1939 (Jan.-July)	5.405	7.609

The use of Reserve Bank credit in this way is, to say the least, quite inflationary, quite apart from a substantial deficit in the account at the end of the season. The effects of this policy proved to be far reaching and caused serious problems for the Government, especially in connection with the depletion of London funds. These will be discussed in the chapter on Import and Exchange Control

One of the main assumptions of the Guaranteed price system has been that it would be used as a stabilising influence, smoothing out the farmers' returns and sheltering New Zealand from the effects of fluctuations in overseas prices. Apparently the procedure would be to fix a price which would be maintained over a period of years, or at least a price which would vary much less than market prices. This price would be lower than market prices when the latter was high and higher when it was low. Any deficit in the Reserve Bank in bad times would be liquidated when conditions improved. If this system could be adhered to it would possess several advantages of a stabilising nature. But there are very grave doubts as to whether such a policy is politically practicable. The history of the guaranteed price scheme so far indicates that it is not politically possible. Up to the outbreak of this present war the Labour Government had not extended the system to meat and wool, despite its pre-election pledges to do so. Pressure has been consistently applied to the Government to raise the prices for dairy produce on the grounds that production costs and the cost of living have risen, despite the abvious fact that the deficit in the Account ihas increased annually. Failing an upward trend in world prices the Government will have to reduce the prices paid for dairy produce, or continue with deficits in its account. As has been mentioned above it is practically impossible to resist the increased pressure for increased prices. On the other hand it seems equally clear that the guaranteed price procedure cannot be maintained indefinitely in conjunction with increasing annual deficits in the Primary Products Marketing Account.

It is impossible to forecast the future of this scheme. It is admitted that some beneficial changes have been effected especially in connection with the marketing of dairy produce in the United Kingdom. Taken separately it would appear that the guaranteed price system has been conducive to greater stability of farm income and that it has been conducive to higher real income amongst farmers. But when considered in relation to the Government's policy as a whole there arise some serious qualifications. It reflects again the confusion between real and money income which is deep-rooted in the philosophy of the Labour Government, and the confused thinking which surrounds problems of the sensitive dependence of New Zealand's economy upon overseas factors. Import and exchange control has greatly accentuated the dangers arising from deficits in the dairy industry account, high public expenditure and monetary expansion. Inflationary influences can no longer be diminished by increased imports and capital export; they fall with full force upon the movement of prices within New Zealand. Rising costs due to those causes will thus increase the pressure on the Government for still higher guaranteed prices. The Government will find it even more difficult to reduce the prices paid to producers, under these circumstances. The outlook for the guaranteed price scheme is far from encouraging. Unless the situation is relieved by a substantial rise in export prices (a most unlikely assumption in face of world conditions to-day) New Zealand will be faced with progressive deficits in its Primary Products Marketing Account.

(II) INTERNAL MARKETING.

The Primary Products Marketing Amendment Act 1937 empowered the Government to establish an Internal Marketing Division of the Primary Products Marketing Department together with such other divisions as might be required. Powers of price fixation were defined to cover dairy produce, fruit, honey, eggs and such other foodstuffs as might be brought under the provisions of the Act by Order-in-Council. In addition to fixing wholesale and retail prices of such foodstuffs the Department could also determine the conditions of sale. Under new legislation enacted in 1939, the Department was empowered to buy or sell any specified goods and sell or otherwise dispose of them for consumption within New Zealand, such prices to be fixed by Order-in-council.

Internal marketing operations were commenced in 1937. Opeeations commenced with butter and cheese, but were later extended to cover fruit, honey, eggs, maise, bobby calves, Kauri gum and barley. The objectives of the Department of Internal Marketing are (1) to equate returns for export and local sale, (2) to rationalise distribution by lincensing wholesalers, (3) to avoid overlapping by defining marketing areas (4) to eliminate disturbing competition through trade discounts and other concessions, and (5) to smooth out seasonal fluctuations in prices.

Import and Exchange Control having been imposed, the Department became the agent for the direct importation of such fruit as citrius fruits and bananas, maise, barley and onions, and for the export of the seasonal surplus of eggs and potatoes. In addition the Department assumed control of the importation of such food stuffs as dried fruits and vegetables, canned fruits and vegetables, fruit juices, fruit pulp and hops.

In regard to commodities, such as dairy produce, which are exported but not subjected to the competition of imported goods, the internal marketing scheme has effected some beneficial changes and has proved conducive to greater economy and efficiency of marketing. Internal marketing is thus complementary to the guaranteed price procedure. In regard to commodities which are subject to import competition, the internal marketing scheme conveniently fits into place with the Government's policy of "insulation." It is thus incorporated in the Import and Exchange Control Scheme. The Internal Marketing Department deals with controlling supplies and prices as well as with the distribution of the products controlled. The motive of protecting local industries will considerably influence the Department in its decisions. The Department may also affect the distribution of trade between products by varying the prices of some of the products to compensate itself against losses on others.

The policy of the Department differs from product to product, and is still in a state of transition. Generally the policy of the Department appears to be directed to organising the local market by zoning and controlling distribution agencies in order to avoid overlapping, price-cutting, concealed rebates and so on. In other cases the policy of the Department is to control imports such as lemons, or to handle exports, namely eggs and honey, at guaranteed prices. In this way it hopes to avoid seasonal fluctuations. In still other cases the Department leaves the distribution to certain "trades". It would appear that, taken together this policy of internal marketing over-emphasises the importance of the producer at the expense of the consumer.

(III) WHEAT CONTROL.

One of the most interesting attempts to stabilise production and returns to farmers is that of wheat control. The history of wheat control in New Zealand does not begin with the Labour Government:it began during the 1914-18 World War when a Board of Trade was set up under the Cost of Living Act 1915. Since then movement towards wheat control has steadily increased until in 1933 a Wheat Purchase Board was established, consisting of four representatives of each growers and millers, whose responsibility was to arrange for the purchase and sale of wheat at fixed prices.

Under Labour's legislation this Board became known as the Wheat Committee and its functions were extended under a scheme designed for "the stabilisation and rationalisation of the wheat growing,flour milling and bread baking industries".

It was the expressed intention of the Government to make New Zealand self-supporting in the production of wheat. It was in line with the Government's policy of guaranteed prices for farm products. The new scheme effected several important changes in respect to this industry. In the four main centres the prices of wheat, flour and bread were fixed at the same level, while the price of bread in other centres was also controlled. Consequently the prices of flour and bread were raised in the South Island centres where wheat is produced and where a price war had been raging, and lowered in the Northern centres. This change was especially welcome in the Northern centres, which up to this time, had rightly complained that the Wheat Control Scheme had penalised them. Henceforth prices could be varied only by the consent of the Minister of Industries and Commerce. The State also controls the wages of employees in both the wheat and flour milling industries.

The objectives and methods of the scheme as elaborated under the present Government are:

(1) The administrative authority is the Wheat Committee. It is under the control of the Department of Industries and Commerce.

(2) The sliding scale duty on wheat and flour continues in operation.

(3) All purchases and sales of wheat are made by the Committee.

(4) The prices of wheat, flour and bread, and by-products if necessary, are fixed.

(5) Prices are equalised in the four principal centres.

(6) The out-put of flour mills is controlled; supplies are allotted to existing mills, and expansion and entry into the industry are controlled.

(7) Imports of wheat and flour are forbidden except under special official licence.

From the above brief survey of the control of the wheat industry it is clear that the price of wheat has been stabilised to a greater extent, but generally wheat prices have been higher than those which would have resulted from a free market. One result of this has been to benefit the producer at the expense of the consumer.

Consumers, especially those in the non-wheat producing areas, who enjoy no compensating advantage as a result of higher prices, have realised fully the burden of control. Its effect is seen in the fact that during the last twenty years the New Zealand price of wheat has been on average, substantially higher than that of Australia.

The control of the wheat industry so far, has achieved the regulation of milling and baking, the orderly disposal of surpluses, the elimination of cut-throat competition amongst bakers and a considerable degree of price stabilisation. On the other hand it has not succeeded in making New Zealand self-sufficient in wheat production and it has benefited the producer at the expense of the consumer. While it has made advances in the directions of price control, it has not yet determined costs. It suffers from the same disadvantages of the other Government schemes of control of farming products: the trend of prices is upward and to attempt to lower prices would be an act of political insanity. No Government which has to face an election every three years can afford to take this risk.

CHAPTER VI

TRANSPORT POLICY.

(I) THE GENERAL PROBLEM:

There exists an extensive system of State owned railways in New Zealand which has been costly to construct owing to the rugged relief and the scattered centres of population. The cost to the country has been some £ N.Z. 65 millions. Until about 1928 this system was usually able to pay its own way both as regards running costs and interest on capital. Profits were utilised to effect improvements in the service. But conditions have radically changed during the last ten years and this service can no longer pay its interest rates in full, the deficit being made up out of the Consolidated Fund. This has been due mainly to the increasing competition of road transport and partly to defective accountancy methods in the past which did mot make adequate provision for depreciation. The railways had been showing false profits over a number of years and these profits had been utilised to improve the service. Large sums of public money have been sunk in unproductive branch lines which even without road competition, could not hope to pay more than a small proportion of their interest on capital, if they paid operating costs. Many of these lines too, have been constructed for political rather than economic reasons. Despite their serious handicap it is possible that the railways, under non-political management might have paid their way, but the emergence of road competition prevented this. Road transport in New Zealand as competitor to rail transport became important as far back as 1920, when the annual consumption of petrol was 54 million gallons. Just prior to the imposition of petrol restrictions in 1939, the annual consumption had risen to 92 million gallons; despite the vast improvements in motor engines and the consequent increased mileage per gallon. In the number of vehicles per head of population New Zealand is exceeded only by the United States.

Estimated Capital Investment in Transport in N.Z. as at 31st March 1938. (excluding overseas shipping.)

Item	Source of Figures	Amount (N.Z.m)
Railways.	Annual Statement of Accounts.	55.99
Road Transport Vehicles.	Values estimated.	147.60
Tramways.	Local Authorities Handbook.	5.55
Shipping	N.Z.Official Year Book	19.00
Air Transport	P.W.D. estimate	1.00
	Total	229.14

This table provides an estimate of the amount of capital invested in transport facilities within New Zealand. It is interesting to compare the relative operating expenses of road and rail transport. In 1938-39 it is estimated that £N.Z. 11.5 m. was spent on petrol and if petrol be taken as one third of the total cost of operating road vehicles, the total expenditure on road transport would be £ N.Z. 35.5 m. This figure indicates the general magnitude of the amount the community chooses to spend on road transport. In the same year the gross earnings or the community's expenditure on railways, excluding the subsidy from taxation, amounted to £ N.Z. 9.35 m., or less than one third of the expenditure on road traffic. It thus appears that New Zealand normally uses road transport about three times as much as rail.

On the other hand it is difficult to isolate particular causes for changes in railway revenue. It cannot be concluded that the amount of transport handled by motor vehicles is so much loss to the railways, because road transport was largely created by the motor itself. Moreover road transport in many instances functions as feeders to the rail. Such factors as the general condition of trade, both internal and external, and by the changing distribution of population are of importance.

The following tables give some indication of the changes in railway revenue in recent years.

Revenue Passenger Traffic 1928-38

Year ended 31st March	Total Passenger Journeys. (million)	Journeys per Capita.	Passenger train miles.	Revenue £ N.Z.m
1928	25.35	17.6	3.94	2.15
1929	25.54	17.5	4.84	2.12
1930	25.38	17.2	4.82	2.00
1931	22.78	15.2	4.87	1.78
1932	19.15	12.6	4.44	1.34
1933	18.37	12.0	4.35	1.37
1934	19.05	12.4	4.55	1.34
1935	19.65	12.6	4.65	1.37
1936	20.36	13.0	4.75	1.47
1937	21.24	13.45	5.07	1.61
1938	22.44	14.1	5.32	1.68

From these figures it is apparent that there has been a heavy decrease in passenger traffic, and a large part of this must be due to motor transport. The number of passenger journeys has decreased but on the other hand number of their miles run has shown a substantial increase. The revenue from passenger traffic has fallen considerably. The railways have made large reductions in passenger's fares in an endeavour to maintain this branch of traffic. Substantial improvements in the second class accomodation have been accompanied by a decrease of nearly 50 percent in first class passenger revenue. These improvements has also increased the cost of haulage. It would seem however that the railways is getting a larger proportion of long distance passanger traffic, while it is loosing short distance traffic to road transport.

Revenue from Goods Traffic 1928-38

Year ended 31st March	Goods & Live Stock £(tons)m.	Ton Mileage of goods etc.	Total Goods etc. Revenue £ N.Z.m	Revenue per Ton Mile(pen
1928	7.36	469	4.72	2.40
1929	7.61	488	4.90	2.41
1930	7.79	512	4.96	2.32
1931	6.96	467	4.54	2.33
1932	5.82	405	4.08	2.41
1933	5.49	363	3.83	2.52
1934	5.64	384	4.00	2.50
1935	6.02	420	4.23	2.42
1936	6.19	444	4.43	2.39
1937	6.81	496	4.91	2.37
1938	7.52	561	5.50	2.35

These figures indicate that the railways have been better able to maintain their volume of traffic and revenue in this branch of transport. Revenue per ton-mile has been fairly well maintained despite many cut rates and concessions. The decline in the volume of goods handled since 1930 is serious. Much of this decrease from 1931-34 was obviously due to slump conditions, although of course the volume of agricultural produce did not fall off during this period. It has been noted elsewhere that New Zealand was well on the road to recovery by 1936 but it is significant that the tonnage of goods handled by the railways did not increase in proportion to the general business turnover in other spheres of economic activity. From these figures it seems quite clear that the railways have not secured its proportion of increased business.

(II) THE REGULATION OF TRANSPORT.

A Ministry of Transport has existed since 1929 and has since expanded so as to employ 185 persons at an annual cost of £ 83,000. It is responsible for the administration and legislation dealing with motor traffic, and for licencing of road vehicles under the Transport Licencing Act 1931. This Act aimed "to regulate motor traffic with a view to securing co-ordination between it and other forms of traffic, and to secure organisation from the stand point of maximum utility." The country was divided up into ten transport districts, this number later being reduced to four. Both goods and passenger services were required to take out licences, to be reviewed at three yearly intervals. A Transport Appeal Board was instituted, later being replaced by a Co-ordination Board. The Act of 1936 abolished the Co-ordination Board and its powers and duties were vested in the Minister of Transport. The object of this legislation was "to provide proper machinery for the co-ordination of private enterprise with the Railway Department." It was indicated too that the revenue of the railways should be protected by the elimination of services in direct competition with it.

It cannot be claimed that the system of licencing of motor transport has been a success in the wider field of transport. It may be true that some elimination of wasteful competition within the road transport industry, but the problem of road versus rail transport is one that has yet to be competently approached. The new Labour Government, by vesting the powers and duties of the Co-ordination Board in the Minister of Transport, made no effective radical change in the operation of the system. It may be true on the other hand that the Ministers of Transport and Railways are not able to work in closer collaboration under the new legislation.

In 1937 however, the Government effected substantial changes, when it proposed to buy out a number of passenger and goods services which were operating in direct competition with the railways. In addition it used pressure to bring about the amalgamation of certain fleets of goods and passenger services. But if the aim is the complete co-ordination of road and rail it seems that something more than this is required; The railways must be able to adjust fares and time tables to get the best results from the combined services. In the absence of any positive policy of co-ordination of road and rail services, serious problems have arisen in both branches of the industry.

First, with regard to road transport. It has happened, probably without full consideration of all circumstances, that the control exercised by the Government discriminates heavily against road traffic in favour of the railways. This is to a certain extent inevitable when some of the transport facilities are owned by the State. Since the railways are State owned there is a temptation for the State to control competitive services in order to preserve the capital value of its own services. In New Zealand road transport has had to bear increasingly heavy taxation, while the railways have been heavily subsidised in recent years from taxation. It is adm mitted that road transport should pay its share of road costs by taxation, such taxes are merely a part of road running costs. But taxes imposed on road transport for other purposes are indirect taxes which are passed on to increase production costs, and tend to retard consumption and production. Professor A.H.Tocker[1] considers that it would be just as logical to tax the coal used on the railways and to impose import taxes on railway materials, as to tax motor fuel and road vehicles for purposes other than road expenses.

In 1938-39 taxation on motor vehicles was £ N.Z. 6.29 m of which £ N.Z. 3.44 million was devoted to roads and £ N.Z.2.82 million to general Government revenue. The tax on petrol was raised to 14.7d per gallon of which 6d was devoted to road purposes and 8.7d to other purposes. Consequently motor transport bears a heavy burden of general taxation, as well as contributing to road maintenance.

The railways on the other hand are heavily subsidised from taxation, a portion of which comes from the taxation paid by motor transport. The following table shows the deficit of railway expenses which has to be made good from taxation.

1 Chamber of Commerce Bulletin No 191.

Railway Returns 1935-39
£ N.Z. m.[1]

Year ended March.	Revenue	Expenditure	Net Revenue	Interest Charges	Deficit
1935	6.63	5.54	1.09	2.33	1.22
1936	7.00	5.95	1.05	2.30	1.25
1937	7.79	6.89	.09	2.31	1.41
1938	8.63	8.00	.63	2.34	1.71
1939	9.35	8.64	.70	2.42	1.72

The figures show an increase in railway revenue due to the general expansion of trade from 1935-38 but expenditure increased more rapidly and net revenue continued to fall until the new earnings of the railways were lower than in the worst years of the depression. In 1938-39 some improvement was effected as a result of a 10 percent increase in rates, but this improvement was slight owing to an increase in expenditure. The deficit has increased steadily since 1935.

An unsatisfactory situation has thus developed in the transport system of New Zealand where uneconomic taxation is imposed upon payable road transport and used to subsidise unpayable railway transport. Despite this very obvious state of affairs, the Government is persisting with its expansionist policy of spending large sums of public money on railway transport and constructing new lines where they have little, if any prospect of paying. At the same time the Government continues to further restrict road transport which not only pays its own

1 op cit No 191.

way but which also contributes revenue to offset the deficit of the railway returns. The continuance of this policy will merely accentuate the present embarrassing position of the railways in the future , while its effects must operate to the detriment of internal business.

The difficulties of the railways may be attributed to a variety of factors. The Government has shown its willingness to give consideration to the current belief that road transport is the main cause of railway difficulties. Since the State owns and operates the railways this attitude is understandable. But there are other serious weaknesses not due to competition. In recent years, and in particular since the depression, railway difficulties have been created largely by the Government itself. The improved working conditions, the forty hour-week, the increased wages paid to employees and the increase in the numbers of employees have greatly increased the running costs of the railways. In addition the Government has undertaken a considerable amount of new railway construction, at a time when the cost of construction is at its highest. These new lines have less chance of paying than those already operating.

The following table of railway returns will make these points clearer.

Railway Rates and Output 1935-39
Index Nos.[1]

Year ended March.	Traffic Rates.	Total Revenue.	Balance of Business.	Number of Employees.	Output per Employee.
1935	100	100	100	100	100
1937	105	118	112	119	94
1939	110	141	127	152	84

The most striking feature shown by this table is progressive and substantial fall in the output per person employed on the railways. If the 1935 output per person had been maintained and the present expenditure reduced proportionately it is probable that the railways would not have required the subsidies from taxation which have been paid since then to meet the steady falling productivity of labour. It appears that the Government has created employment on the railways as one means of easing the unemployment problem.

In 1930 a Railway Commission investigated problems associated with this branch of the transport system. It concluded that many of the difficulties were the result of long years of political mismanagement of railway affairs, of unwise construction of new lines unlikely to pay, some of which parallelled existing roads or sea routes, of political control of freight rates involving concealed subsidies to other industries, and of interference in staff control to the detriment of efficiency and organisation. As a result of this Commission the railways were administered by a Railways Board re-

1 op cit.

latively free from political control. But in 1936 the Labour Government restored full political control of railway affairs and embarked upon a policy of the kind that the 1930 Commission had found responsible for many of the difficulties of railway transport. Consequently the difficulties of the railways will tend to increase rather than decrease in the future.

(III) FUTURE POLICY.

Despite the Government's professed policy of the rationalisation of industry, and the introduction of the Industrial Efficiency Act in November 1936, its achievements so far in connection with transport in New Zealand, leave much to be desired. In road transport the methods followed have taken the form of heavy taxation, the control of imports and increased State regulation. This policy claims to be directed towards rationalisation and co-ordination, but, if that is so, it has not succeeded. It has achieved the elimination of some road services competion with the railways, the amalgamation of existing competitive services, the sale of road services to the Railway Department, thus giving the railways increased monopoly on the roads. Road transport has been further handicapped by State supervision of rates, time tables and schedules. Government policy discriminates heavily against road transport in favour of rail transport which is State owned and operated.

On the other hand, while road transport is being reduced, the Government continues to increase future transport problems by expanding railway construction. Road construction has also been increased considerably, annual expenditure rising from about £ N.Z. 8 million in 1935-36 to £ N.Z. 13 million in 1938-39. It appears that the Government has been far more concerned with solving the unemployment problem than the problem of rationalising transport. Admittedly a case can be made for the utilisation of rail transport on the grounds that a tremendous amount of public money has already been expended in railway construction and some return on this money is better than none at all. Consequently some control is essential.

In New Zealand there is ample scope for Government control of the transport system. The methods adopted to meet this need should be designed to cover the whole field. They should not hamper efficiency and desirable economic progress; they should embrace rail as well as road transport, new construction as well as current operation and import control of transport requirements. In particular they should consider seriously the possible future development of air transport, especially in the post war period.

Transport is perhaps the most vital of all economic services as production, trade and employment are all dependent upon it. It is of fundamental importance that transport policy should give the consumer the maximum practicable freedom of choice and should enable any form of transport to expand freely in response to demand. The consumer is by far the best judge of what is best for the production and trade in which he is engaged. Control, to be beneficial, should therefore aim at providing the most efficient services in the most economical way.

From the above analysis of the transport problem and the extent and trend of State regulation, it will be seen that much more is required to establish a sound economic and efficient transport system in New Zealand. A complete reorientation of policy is imperative. It is difficult to believe that the control of transport up to the present has been the result of deliberate and considered policy. On the contrary there is an abundance of evidence to show that no definite transport policy has yet been formulated, and that the Government has decided to pursue a policy which has proved harmful in the past and likely to prove even more harmful in the future. Far from effecting the rationalisation of the transport system with a view to providing more efficient and economical services, the Government has merely discriminated heavily against road transport in favour of its own railways. In other words it has failed to face the issue of co-ordination between road and rail altogether.

CHAPTER VII.

THE RATIONALISATION OF INDUSTRY.

(I) THE GENERAL PROBLEM.

A section of a previous chapter dealt with the characteristics of the New Zealand economy, and emphasised the high relative importance of the farming industries in the national economy. On the other hand it was pointed out that conditions in New Zealand were not favourable to a high degree of industrial development. Mention was made also of the fact that the Dominion was largely dependent upon overseas markets, especially in Great Britain, for the disposal of her primary produce. Having regard to these fundamental facts, it is not at all surprising that in the past, the objectives of New Zealand's economic policy have been mainly concerned with overseas trade and more particularly the share of the United Kingdom and other Dominions in that trade. Domestic manufacturing industry was not fostered as a matter of policy although such industries as were in existence constituted a political "pressure" group of some importance, and had obtained the protection of tarrifs - usually about twenty per cent. Moreover such shelter as domestic industries had managed to obtain was not taken from them. The existing position in regard to New Zealand's development of manufacturing industries is described in the Official Year Book for 1940. It classifies New Zealand's industries as follows:

> Group I comprises those industries engaged in the preparation of farm products for the market, with the resulting by-products. The added value is relatively small in proportion to the value of the output. These industries comprise meat freezing and preserving, ham and bacon curing, butter and cheese making, sausage casing making, fellmongering and woolscouring, boiling down and manure making.
>
> Group II covers the public utilities with large capital assets operating under monopoly conditions. It comprises gas works, electrical generation and supply.
>
> Group III consists of what are usually termed semi-primary industries, utilising natural resources. "Added value" is high. The group includes saw milling, fish curing, lime crushing, brick, tile and pottery making, flax milling, concrete black and fibrous plaster making.
>
> Group IV includes all those industries for which statistics are available and which are not included in the first three groups. It includes borderline cases such as grain milling and also, several "repair" industries such as motot repairing. Generally speaking this group represents the "true" manufacturing industries of New Zealand.

The following table represents the principal statisticss of the various groups in 1937-38.

Factory Returns 1937-38.

Group.	£.N.Z. Value of Output.	Number of Employees	£.N.Z. Wages paid.	£ N.Z. "Added Value".
I	52,191,872	13,498	3,594,568	6,680,806
II	7,189,456	5,347	1,428,989	2,332,274
III	7,424,367	12,014	2,763,509	5,226,842
IV	46,885,861	71,485	13,194,521	24,367,461
Totals.	113,691,556	102,344	20,981,587	38,607,383

None of the above groups covers the extractive industries, building construction, or farming proper, although of course, a large part of farming products enter as the raw materials of Group I.

It is clear that the first three groups are almost inevitable or indigenous in New Zealand. They are not subject to any appreciable extent to competition from overseas. The "true" manufacturing industries are individually small, scattered and often uneconomical. Large scale manufacturing industries have only recently appeared. A notable example is the motor assembly industry.

The defects of New Zealand's factory industries are to be found in efficiency and organisation, including the overlapping of factories on a limited market. On the other hand there is no lack of enterprise: the range of products is considerable. It includes cloth and clothing, boots and shoes, hats, corsets, silk stockings, umbrellas, refined sugar, chocolate, wine, phosphates, electric and gas ovens, enamel baths, lawn mowers, steel office furniture, aluminium ware, milking machines, concrete mixers, insulators, bowser pumps, ammunition, brushes, matches, paint, radio sets, bakelite, golf clubs and the like. This variety of products itself, implies a preponderance of small individual units since the market for many of these products is limited. But there exist, on the other hand, some industries such as the boot and shoe industry, in which an excessive number of small factories cater for a relatively small market. The following table gives the number of operatives employed in thirty two factories.

Sizes of Sample Factories.

Number of Factories	Number of Operatives.
5	Over 200
2	150 - 200
5	50 - 60
8	20 - 50
12	Under 12.

Although the relatively small size of individual establishments is a feature of the factory industries, their importance as an avenue of employment is considerable. Admittedly the future expansion of farm production and employment must in the last analysis be conditioned by overseas markets, since over seventy per cent of farm produce is exported. But at the same time there are good indications that overseas markets are not likely to expand in the future as they have done in the past, and that expansion of employment in the farming industries has slackened in recent years. In contrast, there are indications that factory industries offer wide possibilities for increased employment in the substitution of New Zealand factory products for imports. The employment in the "true" manufacturing industries has shown a marked increase during the past twenty years.

New Zealand, by virtue of the dependence of its farming industries upon export prices, experienced the full impact of the economic depression when these prices slumped. This hard fact demonstrated also the economic weakness of virtually entire dependence on the farming industries, and the necessity for a more diversified or balanced economy. Accordingly, the Labour Party formulated certain "insulation" proposals, which implied a vigorous programme of industrial expansion both as a means of creating employment and of protecting New Zealand from the drastic consequences of overseas fluctuations in export prices. The position was summed up by the late Prime Minister, the Right Honourable M.J.Savage, as follows:-

> "If British policy now precludes the sale of our exportable surplus products in the United Kingdom at economic prices, in sufficient quantities to enable this Dominion to continue to progress, then obviously New Zealand is faced with the necessity of adopting one of two alternatives. Either we must develop our own manufacturing industries and thus provide internally the expanding market that is necessary for the prosperity of our people,or we must attempt to find foreign markets for New Zealand's primary products.
>
> "If the first alternative is adopted it means that New Zealand must make for itself a considerable portion of the articles, which at present we purchase from the United Kingdom. Naturally we would concentrate only on those industries best suited to our economy. We have no desire to set up uneconomic industries behind the shelter of a tariff. Rather we would attempt to organise industry on a rationalised plan.
>
> "- - - - - - - - - - - - If however we achieve a more balanced economy and produce more of our own manufactured goods,we should be in a position not only to absorb that considerable portion of our own people who at present are unable to find normal avenues of employment, but also to maintain a much

greater population".

The words "organise industry on a rationalised plan" are important:they indicate a new train of thought.. Although the Labour Government advocated a programme of the rationalisation of industry, even before they were elected to office, it is important to remember that prior to 1936 the trend of much legislation was in the direction of more and more detailed regulation of industry and trade. Much of this was doubtless due to the depression, although some critics consider that the existence of such regulation was one important cause contributing to the length and severity of the depression itself. It was however under the Labour Government that the first thorough-going attempt to "organise industry on a rationalised plan" was made.

(II) THE INDUSTRIAL EFFICIENCY ACT 1936 AND ITS ADMINISTRATION.

With the passing of the Industrial Efficiency Act in November 1936 and the subsequent establishment of a Bureau of Industry, it appeared as if the new Labour Goverment would take early and active measures in the direction of a planned development of manufacturing industries. The general purpose of this Act as described in its title is "to promote the economic welfare of New Zealand by providing for the promotion of new industries in the most economic form, and by so regulating the general organisation, development, and operation of industries that a greater measure of industrial efficiency will be secured". It is important to notice that the term "industry" includes not only manufacturing, but also any trade,occupation,business, works or service of any kind whatsoever.

Under the Act a Bureau of Industry was set up, which was comprised of special and ordinary members, all of whom are appointed by the Minister of Industries and Commerce. Ordinary members are persons employed in the service of the Government who in the opinion of the Minister possess special qualifications which enable them to render valuable service to the Bureau. Special members are nominees of manufacturing and agricultural industries,and power is given to the Minister, if he thinks fit, to appoint further special members to represent other industries, or the workers employed in any industry. The Bureau, which meets at regular intervals acts as an advisory body to the Minister of Industries and Commerce, in matters pertaining to the establishment and development of new industries; the rendering of any Government assistance to industries; the raising of the qualities of products; the adaption of uniform methods of accounting and costing; the preparation of statistics; standardisation of materials, processes,or products; the training and supply of workers; and the marketing and distribution of products.

The functions of the Bureau are thus extremely wide. The Minister can require that any industry specified by him shall be carried on only pursuant to a license issued under the Industrial Efficiency Act, and the Bureau is the licensing authority in this connection. The Minister is the appeal authority against the decisions of the Bureau in respect to licensing. A further duty of the Bureau, closely allied to licensing, is the preparation of industrial plans for industries with a view to securing greater efficiency in such industries.

The Minister may on the advice of the Bureau, arrange to have any such plan applied to the industry concerned, although any such plan must be approved before adoption, by the majority of those engaged in the industry.

Regulations under the Act may be made for a wide range of purposes including the fixation of prices, royalties, discounts and the like, the control of production and marketing, the standardisation and simplification of materials, processes and products.

It will be seen then that the powers of the Bureau are very wide in that it has the power to recommend to the Minister virtually any measure deemed necessary for the rationalisation of existing industries and the establishment of new ones.

The passing of the Act and the establishment of the Bureau met with a mixed reception. There was a fairly wide-spread recognition of the need for new definitions of the relationship of State and industry, and many manufacturers feel that the Act was the very thing for them. It would give them the protection they required, as the Industrial Committee established for each industry would represent mainly producers. On the other hand some progressive manufacturers feared that the activities of the Bureau would retard their development. And again consumers felt that the Bureau would be utilised to assist manufacturers to remain in business rather than make business efficient.

The record of the Bureau during its first three years of operation suggests that some of these earlier misgivings were not undfounded. In the first place many of the Bureau's activities had to be delegated to committees. These committees were later replaced by an Executive of five members. Much of the Bureau's activity was concerned with licensing. By the end of 1939, twenty-five industries had been gazetted as licensed industries. Apart from licensing, only two industrial plans have been put into operation, namely the New Zealand flax (Phorium tenax) and the pharmacy industries. In regard to the former industry the scheme formulated by the Bureau of Industry provides for the minimum guaranteed prices for fibre, licensing of flax mills, and advisory service for flax millers, marketing of fibre by the State, a research organisation, flax experimental farm and experimental mill both owned and controlled by the State. Generally it represented a thoroughgoing attempt to rehabilitate a declining industry which for some years past had been subject to depressed market conditions and which had also been supported by financial aid from the State. The pharmacy plan effected certain improvements in the industry together with some reduction of charges. But it has been subjected to severe criticism on the grounds that the plan merely preserves the uneconomic set up of the industry, eliminates competition, and discriminates against the consumer. The following subtle criticism of the Pharmacy plan appears in an issue of a New Zealand periodical.

"The plan gives the chemists who are to be made efficient a monopoly over their industry; it allows them to withhold licenses from Boots or any other concern that seems efficient; it does not fix standard fees for dispensing or an artificial drug price list; it forbids the economic competition of wholesalers or manufacturers; it gives chemists the monopoly right to sell certain substances; it preserves the uneconomic set up of the industry; it gives majority control to the chemists themselves; it gives employees a vested interest in preserving the uneconomic status quo without giving them a controlling voice; it gives absolutely no representation to consumers who are the very reason for the chemists existing; it confers official recognition on a closed corporation of producers giving them power to continue their existence, eliminate competition, and make the consumer pay. There are two good things about the scheme, one that the chemists will themselves have to pay for its administration, and two, that the Minister has the controlling voice. He can turn down recommendations and veto plans. He, we gather, will represent consumers, but how can he get his information, when the ones who supply it will be chemists themselves? He will be handicapped from the beginning with lack of knowledge." [1]

Another measure which may have an important bearing on the future of industry in New Zealand is the Iron and Steel. Act of 1937, which authorised the establishment of a State iron and steel industry at Onekaka. For this purpose the Government was empowered to borrow the sum of £ N.Z. 5 Million from the Reserve Bank. Progress with this project is at the moment at a standstill.

When judged by the usefulness of its achievements, the Industrial Efficiency Act so far has not proved an outstanding success. Allowance must be made of course for the fact that the Bureau up to the present has been feeling its way,

1 "Tomorrow" December 8 th 1937.

and that in the early stages it would be too unwieldly a body. This was more especially the case when it is remembered that the Bureau is composed fo busy members(departmental heads and business men) who could devote part of their time only to Bureau work. The subsequent creation of an Executive helped to ease this problem. There are certain spheres of activity in which the Bureau has proved beneficial to industry, namely its explanatory and advisory services. While the scope of the Bureau's activities call for no comment, lack of co-ordination of these activities and the manner in which they were dispersed have not been conducive to "organising industry on a rationalised plan."

(III) THE RATIONALISATION OF AGRICULTURE.

This particular aspect of the rationalisation of industry will be treated more fully in a subsequent chapter on Marketing. All that is intended here is a brief outline of the regulation of agriculture, in order to consider it in relation to the general scheme of the Government to organise industry on a rationalised plan.

Because of the predominant importance of farming in the economic life of New Zealand, a great deal of the effort of Governments, both present and past, has been directed to improving the position of farming industries. Among the various measures adopted may be mentioned land settlement schemes, the State Advances and Rural Credit Schemes, various public works schemes covering clearing the land, drainage and irrigation, subsidies on the carriage of lime and fertilisers, research and instruction by Government Departments, schemes for the subsidising or control of production and marketing of various farm products such as wheat and dairy produce, mortgage reduction, re-organisation of internal and external marketing, and Guaranteed Prices for farm products.

This trend of State regulation of agriculture has been one of the outstanding developments during the post-war period. The present Government has merely accentuated it. The principal changes effected by the Labour Government were the re-organisation of external marketing of dairy produce which was associated with the Guaranteed Price scheme, and the establishment of an Internal Marketing Division of the Primary Products Marketing Department. For this purpose the Primary Products Marketing Act was passed in 1936. An Amendment of 1937 enabled the control to be extended to internal marketing activities. Improvements were also effected in the control of wheat production and the marketing of wheat. In June 1936 also, the Government re-organised the rural credit system. The State Advances Corporation replaced the former Mortgage Corporation. The change of title is significant and was commented on by the Minister of Finance as follows:

"The pychological importance of the old title 'State Andvances' was recognised by eliminating the word 'Mortgage' and calling the institution the State Advances Corporation."

It must be conceded that the Government has substantially improved the external marketing of dairy produce, and the internal marketing of a wide variety of products, including local grown fruit and vegetables, and imported fruits and cereals. Under the guaranteed price scheme for dairy produce an attempt has been made to stabilise the income of the dairy farming community although they suffer to a certain extent from rising costs which are largely the result of the Government's expansionist economic policy in other spheres.

It cannot be over emphasised however that the rationalisation of agriculture, like that of industry shows a marked tendency to benefit the producers at the expense of the consumers.

(IV) GENERAL REMARKS:

The general idea behind the regulation of industry and trade appears to be the desire for a more secure, more stable, more rational and less wasteful organisation of industry and trade. The method followed is generally to investigate the condition of the industry concerned, including both production and marketing, and on the basis of this investigation to license producers and to fix prices, conditions of sale etc. In this way it is hoped to stabilise industry for all those concerned in it, workers and employers, dealers and consumers.

The ideal aimed at seems in many respects a desirable one but its attainment or even its near approach is beset with difficulties and dangers, which, when investigated suggest that the remedy applied might be worse than the cure. For instance the removing or regulation of competition will create the difficulty of providing an alternative to competition which does not consist of monopoly for a privileged few at the expense of.the many. In addition State fixation of prices overlooks the fact that the fundamental function of prices is to equate supply and demand. It is noticeable that in several cases where regulation has been applied and prices fixed, as in the case of wheat, petrol and fertilisers (to quote only a few) the fixed price has been higher than that formerly ruling. Consequently the consumer is penalised. Finally the difficulty of elimination waste without int5oducing another and greater waste will not be easily overcome. The cost of labour and resources required by industry to conform with the regulations, plus the cost of regulation, control and enforcement to the Government must be added to the cost of production.

It is important to notice too, that although co-operation among producers has been an active force in New Zealand for a generation or more, especially in the dairying industry, consumer's co-operation on the other hand is not extensive. This form of selling organisation, so highly developed in conservative Britain and reformist Sweden, has never made real progress in New Zealand. A limited amount of co-operation exists, particularly in connection with the purchase of fertilisers, and to some extent household requirements also, by dairy farmers through their factories. This disparity in the degree of co-operation amongst consumers and producers, means that the former are placed at a distinct disadvantage and will no doubt continue to be so until they become sufficiently organised to rectify the position.

But although the organisation of industry in New Zealand is far from being organised on a rationalised plan, it appears most unlikely that existing State control will be relaxed in the future, on the contrary the reverse appears to be the case. This being so, the extension of control places additional responsibilities on Parliamentary Government as well as additional administrative burdens. To cope with these increased problems the principles and techniques of administration will have to be improved.

CHAPTER VIII

LABOUR AND SOCIAL LEGISLATION.

(I) PREAMBLE.

The most pronounced characteristic of State action in New Zealand has not been in business activities but in the various schemes for redistributing the national income. In no sphere has the State played a larger part than in the regulation of social and labour conditions, particularly in the period since 1890. For a community with a predominant agricultural and pastoral economy, this trend may seem a little curious. From the very beginnings of colonisation the demands of education and social services generally have been matters of public interest. The reason for this may have been that through lack of voluntary community organisations able and willing to undertake humanitarian works, the provision of these services developed upon the State. The strength of this tendency during the past forty years may be gauged from the fact that it has persisted with more or less vigour under all Governments and no one would deny that its strength comes from the wishes if not the convictions of the people as a whole. Thus Dr. J.B.Condliffe could write in 1930:

"If New Zealand can be said to have any social or economic theories, pride and place must undoubtedly be given to the general theory that human considerations should take precedence of economic progress, or perhaps that true economic progress can in the long run be based only on human welfare."[1]

It is only natural that this theory should find whole hearted support in percept and action with the Labour Government. The late Prime Minister, the Right Honourable M.J.Savage, expressed the same idea in the following terms:-

"They (the People) recognise that social justice must be the guiding principle and that economic organisation must adapt itself to social needs. If out institutions fail in this regard, then they must be changed. This is the basis of the policy of the Labour Government in New Zealand."[2]

1 J.B.Condliffe: "New Zealand in the Making."
2 The Rt.Honourable M.J.Savage: Daily Telegraph, London. July 13 1936

It is important to notice that a considerable amount of labour and social legislation was in existence in New Zealand long before the Labour Government assumed office in 1935. The Factories Act, the Shop and Shop Assistants Act and similar measures provided for the regulations of general working conditions, while the Industrial Conciliation and Arbitration Act 1894 aimed to secure the peaceful settlement of industrial disputes. Compulsory Arbitration has been New Zealand's best known contribution to labour legislation. But the growth of social services has been almost continuous since the 1890's. In 1899-1900 there were 11,285 pensions in force and the total cost was £ N.Z. 157,000 or 4/2 per head of population. In 1935 there were over 100,000 pensions of various kinds (including war pensions) at a total cost of over £ N.Z. 3 million. The total Government expenditure in the three branches of the social services, Health, Education and Pensions, for the year 1935-36, at the end of the depression in New Zealand was £ N.Z. 14.313 million. Although expenditure on these services was curtailed and drastic salary cuts were imposed as economy measures during the depression, provision was nevertheless made for the relief of unemployment. In 1933-34 over £ N.Z.4 m had been collected for this purpose. The rise of the Labour Government to power at the end of 1935 brought substantial changes and extensions of labour and social legislation of New Zealand.

(II) LABOUR LEGISLATION.

Practically the first step of the new Government was to pass the Finance Act 1936, by which all Arbitration Court awards, which had been suspended during the depression, were completely restored, and all cuts in salaries and wages imposed during the depression period, whether the workers concerned were working under the Arbitration Court award or not, were restored to their former levels. In September 1937, the Arbitration Court made a pronouncement on 'standard wages'. The following rates were deemed to be the minimum:

Standard Wage Award 1937

Class of Worker	Rate per Hour.
Skilled	2/9
Semi-skilled	2/5 tp 2/7½d
Unskilled	2/4

Further, these minimum rates were intended for a forty hour week and for casual labour; they were not applicable where employment is regular throughout the year.

The Industrial /Conciliation and Arbitration Act 1936, requires the Arbitration Court to fix basic rates of wages for unskilled male and female workers. Orders of the Court made to this end may be amended at not less than half-yearly intervals by a subsequent general order. The basic rate of wages for adult male workers must be sufficient, in the opinion of the

Court, to maintain a man, wife and three children an " a fair and reasonable standard of comfort." The basic weekly wage rate for adult male and female workers was fixed at £3-16-0 for males, and £1-16-0 for females. It applies to all workers twenty-one years of age, or over (except casual workers and those working under apprenticeship contracts.) The basic wage had not come up for review before the outbreak of the present war. It is, however, generally considered that this wage is insufficient, and very few adults actually get paid such a low wage. It is interesting in this connection to compare the effects of price movements upon wage incomes. The following table summarises the position.

Nominal and Effective Wage Rates.

Year	Nominal Wage Rates.	Retail Prices.	Effective Wage Rates.
1934	839	808	1038
1935	859	837	1025
1936	950	864	1100
1937	1036	923	1122
1938	1081	951	1138
1939	1099	980	1121

The improved nominal wage of the workers since 1935 is apparent, although some of their gain is being lost through rising retail prices. This will probably mean that the workers will seek an increase to compensate them for rising costs.

The Labour Government's policy in regard to trade unions was expressed in the introduction of the Arbitration Amendment Act of 1936, namely:-

It is the policy of the Government to have working conditions fixed by negotiation between organised workers and employers, and it is considered reasonable to require all workers to bear their share of the cost and responsibility giving effect to this policy."[1]

Accordingly it bacame compulsory for workers to belong to a union where the award of the Court applied. In addition, compulsory registration of trade unions in New Zealand was introduced. Consequently both the number of members and the financial resources of the Unions increased tremendously. At the beginning of 1936 the membership of the industrial trade unions was 85,929; by the beginning of 1939 it was 241,231, while the number of unions had increased from 410 to 466 over the same period. It is interesting to notice too that at the same time the employers unions showed a definite increase both in membership and numbers of unions. The figures were 131 unions with a membership of 4,344 in 1936 and 248 unions with 9,131 members in 1939. But the significant feature of the trade union development is not so much its spectacular numerical increase, aso much as its increased bargaining power.

There had arisen in New Zealand numerous small and weak trade unions organised on a craft basis and judicial rather than militant action became the accepted means of settling disputes.

1 E.G. Riches: "Restriction of Compulsory Arbitration in N.Z."p 26

Unskilled workers Unions on the other hand had formed an organisation known as the Alliance of Labour. As a result of a conference in April, 1937, these two organisations were dissolved and replaced by a New Zealand Federation of Labour. To this organisation the vast majority of Unions are affiliated. This change was designed to encourage the Unions to become an instrument for the democratic control of industry. The summary of disputes shown in the following table is a good indication that this aim is far from achievement.

Industrial Disputes.
(Number and magnitude)

	1935	1936	1937	1938
Strikes	12	43	52	72
Firms affected	65	128	73	103
Workers envolved	2,328	7,354	11,411	11,388
Working days lost.	18,563	16,980	29.916	35.456
Estimated loss	£ N.Z.	£ N.Z.	£ NZ.	£ N.Z.
in wages.	15,266	12,886	32,129	42,104

The most spectacular move of the Government to improve working conditions was the introduction of the 40-hour week. For workers under all Awards it was stipulated that the Arbitration Court should fix the maximum working hours at forty per week in all industries except in such cases where the Court considered it unpracticable for the industry in question. Under the new legislation it was stipulated that wages may not be reduced nor may employees be dismissed merely because of the shorter hours worked. Restriction was also placed on the amount of overtime that could be worked. In the first year of operation no less than 116 of the 189 awards made by the Arbitration Court conformed to the 40 hour week scheme. The court has provided for Saturday to be free in 48 industries while Saturday work is permitted in 63 industries, where work involved is of a continuous nature. Shops and Offices work a 44 hour week.

In addition the Government affected changes and improvements in the working conditions of the agricultural labourer, under the Agricultural Workers Act 1936. These changes improved both the money wages and the housing facilities of agricultural labourers.

In connection with its labour legislation the Labour Government has ratified no fewer than 22 of the original 62 conventions relating to minimum standards laid down by the International Labour Office since 1919. This is a worthy achievement for any Government in so short a time.

(III) EMPLOYMENT.

The Government took a serious view of the unemployment problem in New Zealand. Although conditions in this respect had improved considerably as a result of increased business activity, by the end of 1935, the problem was nevertheless still acute. The worst period in the depression was in March 1933, when the total number on the unemployment register was 73,650. In December 1935 this number had decreased to 57,281. Thus to a large extent the Government moulded its policy to cope with the problem of unemployment. Unfortunately no full measure of the increase in employment is possible because of the lack of an index of employment in New Zealand together with the absence of adequate statistics of employment in several important fields.

Satisfactory statistics of employment in the agricultural and pastoral industries are not available but there is good reason to believe that employment actually declined there after 1935. The reasons for this decline are not difficult to find. For instance despite the Government's guaranteed price scheme for dairy produce, farmers in this industry were quite unable to compete with the higher wage rates and improved working conditions of labour in the various Government departments, especially the Public Works. To a certain extent this is true also of other non-Government industries. Not only were they unable to compete with the improved wages and working conditions, but private industry failed to attract its share of investments partly on account of the fact that the Government's own policy made the fields less attractive for such investment. This retarded production and therefore employment.

Under these circumstances it is not surprising that the most notable increases are to be found in public employment itself - the Public Service, Railways, Post and Telegraph and in particular the Public Works.

Public Works Employees.

Year	Numbers.
December 1936	19,198
" 1937	20,205
" 1938	23,245
" 1939	22,231

These figures represent workers in the direct employ of the Public Works Department, those employed by public works contractors and those employed by local authorities on (a) works financed wholly or partly by the Public Works Department, and (b) highway or road construction and maintenance. Employment on the public works, however, figured as a temporary measure in the minds of the Government, since they expected that transfers to industry would be progressively possible. Had such an expansionist public works policy been undertaken during the depression it is conceivable that internal business conditions could have been stimulated. But to superimpose that policy on the peak of a boom meant that private industry was hampered rather than helped with the result that it did not attract employment from the public works.

Industrial and factory employment showed a marked increase. Likewise the employment of the building and constructional industries was destined to increase considerably. The following table summarises these increases.

EMPLOYMENT.

Year.	Factory Production.	Building and Construction.
1935-36	86,588	8,346
1936-37	96,401	9,721
1937-38	102,344	11,471
1938-39	102,535	14,040

It is highly probable that, owing to the substantial increase in export prices and consequent increased business activity within New Zealand, a marked increase in employment would have taken place in any case. In fact, there are good reasons for believing that the Government's policy actually hindered the increase in this sphere. The increase in public employment, however, is certainly greater than it would have been under other than a Labour Government.

In conclusion, mention may be made of the fact that the Government has retained certain relief measures, of former Governments, and also added new ones of its own in its endeavour to reduce unemployment to a minimum. These include the various relief schemes and subsidies to farmers who desire to undertake land clearing and improvement drainage projects and the like. These measures however are palliatives only; they do not attempt to remove unemployment by lessening the dislocations which caused it.

(IV) SOCIAL SECURITY.

"Redistributing the national income" has led the Labour Government to vastly extend social services in New Zealand. The year 1936 thus marks a turning point in social legislation. Not only were pension payments restored to their former levels but they were increased as well. The qualifying conditions for a pension are now more liberal than hitherto. Old age pensions were raised to £1 and then to £1 2 6d per week, with a property allowance of £500. The qualifying age for women became 60 years, and the residential requirements were reduced from 25 to 20 years. Widows' payments were increased from 9s for the widow, and 9s for each child, to £1 for the widow and 10s for each child. Deserted wives were classed as widows. Restrictions on the granting of pensions in respect to illegitimate children and to Asiatics were removed.

The Invalidity pension was a new one entirely. It consists of £1 for single men plus 10s for wife and 10s for each child. Qualifications for this pension are incapacity for work as the result of accident or by reason of illness or congenital defect.

The Family allowance was also restored in 1936 to its previous level of incomes up to £4 a week. The increases in wages and employment will cause the numbers benefiting from this pension to decrease, and another economic depression will have the reverse effect.

The highlight of the Government's social legislation was of course the Social Security Act of 1938. It represents the most comprehensive attempt ever made in New Zealand to extend the scope of social services. Its principal features are as summarised below.

Health Insurance.

(a) A univeral general practitioner service to all members of the community who require medical attention.

(b) Free hospital and sanitorium treatment for all.

(c) Free medicine for all.

(d) Free mental hospital care and treatment for the mentally afflicted.

(e) Free maternity treatment including the cost of maintenance in a maternity home, plus, in certain circumstances, a grant to provide outfits for babies.

(f) Free home nursing and domestic help when the necessary staff has been trained to make the scheme practicable.

(g) Extended education for the promotion of health and prevention of disease.

(h) Other services to be provided when practicable:- anaesthetic, laboratory and radiology, specialist and consultant, massage and physio-therapy, transport to and from hospital, and dental and optical benefits.

Weekly Payments.

(a) Payment of age benefit of 30s a week at the age of 60 years, with an income allowance of £1 a week from other sources. A married couple could receive therefore £4 a week. When the man is 60 and the wife not yet 60, allowance will be made under general benefits.

(b) Increase in invalidity pension from £1 to £1 10s a week.

(c) Payment of sickness benefits at rates to be determined.

(d) Increase in children's allowance to recipients of sustenance payments when unemployed.

(e) Increased widow's pension of 25s a week plus 10s a week for each child under 16 (formerly 15) continued in special cases to 18, while the children remain at school. Deserted wives and wives of mental hospital patients will receive the same rates.

(f) Institution of orphan's pension of 15s a week up to aged 16.

(g) Increase in family allowance from 2s. to 4s. a child, with extension of weekly wage qualification.

(h) Increase of miners' and veterans' pension.

It will be seen from this brief analysis of the Social Security legislation that not only was the former pension scheme incorporated in it, but pension payments were increased and new benefits added. Needless to say this scheme is not yet in full operation and probably will not be for some time to come. For instance the medical profession as a whole are opposed to a universal medical scheme for reasons which are apparently not very clear. The finance for the social security scheme is to be partially provided by a universal wage contribution of 1s. in the £1, while the remainder will evidently be a charge on general revenue.

In addition to introducing a Milk in Schools Scheme in 1937 whereby every child attending a school, state or otherwise, will receive a half pint of pasteurised milk daily, the Labour Government has greatly increased the expenditure on education in New Zealand. The number of teachers in training has been increased, the period of free post primary education extended, University bursaries increased and extended and finally, additional grants for adult education activities have been made.

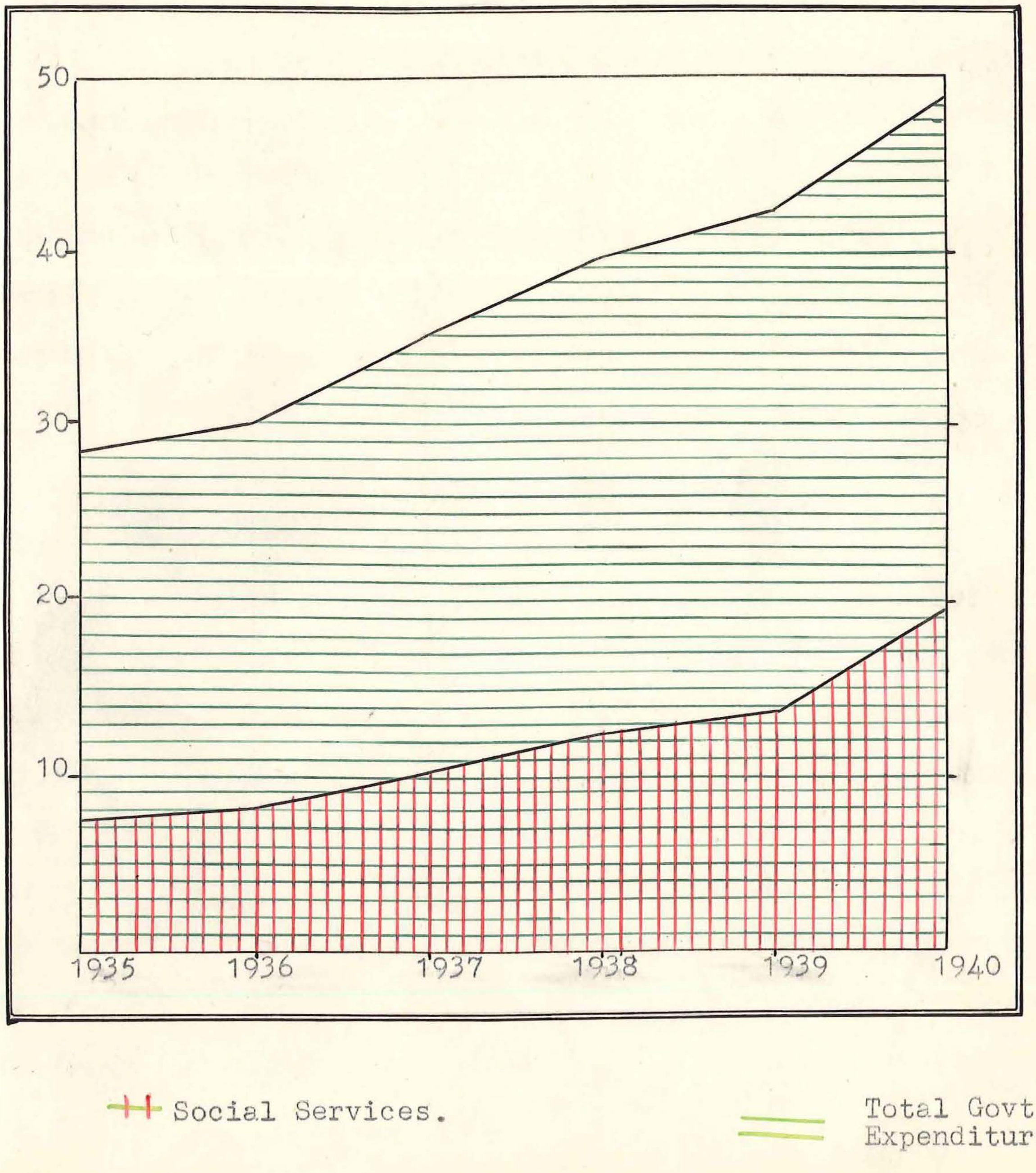
There can be no doubt that the Government's achievements in the sphere of social services in New Zealand have been considerable, nor can there be any doubt that they are highly desirable. The fact remains, however, that this policy however desirable has greatly increased unproductive public expenditure. The following table shows the spectacular increase of public expenditure in social services in recent years.

Social Service Expenditure
£ N.Z. (m.)

Year ended 31st March	Pensions	Education	Health	Total
1936	3.80	3.27	0.88	7.95
1937	5.02	3.98	1.01	10.01
1938	6.44	4.62	1.23	12.29
1939	6.93	5.10	1.78	13.81
1940	12.29	5.56	1.82	19.67

When compared with total state expenditure and state taxation, the expenditure on social services is surprisingly large.

SOCIAL SERVICES AND TOTAL GOVERNMENT EXPENDITURE.



Social Services, Taxation Yield and Total Government Expenditure.
£ N.Z. (m.)

Year ended 21st March	Social Services	Taxation Yield	Total Govt. Expenditure.
1936	7.95	25.48	29.89
1937	10.01	31.16	35.02
1938	12.29	36.78	39.40
1939	13.81	37.76	42.24
1940	19.67	44.49[1]	48.49

[1] Includes special taxation for war purposes.

In 1938 the expenditure on social services alone, including unemployment relief, exceeded the total yield of taxation in the years 1922 to 1928 and 1932 to 1934, and the recipients of pensions of various kinds nearly one-sixth of the total breadwinners of the Dominion. It would be interesting to speculate where this trend of state expenditure will ultimately lead, but it would hardly be relevant to this discussion.

(V) REDISTRIBUTION:

It was largely the Government's motive to redistribute the national income which was responsible for the lavish expenditure on social services, and also for the substantial increases in the money incomes of the wage earners. It would appear that this policy has been successful in connection with the extension of social services. It remains to investigate the amount of redistribution effected through increased money incomes and shorter working hours. An earlier table illustrated the fact that although money incomes had increased, retail prices had increased also with the result that some of that gain was lost. The following summary of the aggregate Private Incomes will be of value in estimating the extent to which redistribution has taken place.

Aggregate Private Income 1936-38
£ N.Z.m[1]

	1936	1937	1938
Wages etc.	66.2	78.3	91.1
Wages Exempt (a)	7.4	9.3	8.9
Pensions.	3.3	4.7	6.0
Other Income.	36.0	49.2	49.9
Other Exempt.	4.4	5.3	5.5
Undist.Coy. (c)	4.0	5.0	5.5
Total.	121.3	151.8	167.0

(a) Includes relief wages, sustenance etc.
(b) Various categories.
(c) Undistributed Coy.Income (including Income Tax payments).

These figures show that "Other" income subject to the tax increased proportionately to wages and salaries until 1938. The same result is obtained from a comparison of (a) wages and salaries plus exempt wages and pensions, and (b) other income, plus "other" exempt income and undistributed company income. These facts indicate that the extent of redistribution achieved through higher incomes and increased employment has not been appreciable.

(VI) GENERAL REMARKS

From the above analysis of labour and social legislation

1 Adapted from an article by Mr.J.O.Shearer in the Economic Record-New Zealand Supplement 1939.

in New Zealand during recent years it would appear that a genuine effort has been made to improve the welfare of the wage earning section of the community. While the objectives of this policy call for no adverse comment, it must be admitted that the Government has confused money income with real income to the detriment of the wage earners themselves. Some critics would argue that as far as labour legislation is concerned, the action of the Government actually hampered absorption of idle labour into industry, and as a matter of fact there is some validity in this argument.

Treated separately, the Government's labour and social policy, while it suffers from certain inherent difficulties, has much to commend it. Under the present Government, labour and social legislation has advanced to such an extent that it almost eclipsed that of any capitalist country in the world. An Australian visitor summed up the position as follows:

> "The workers of New Zealand can have no grievance against the Labour Government. They have been served with promptitude generosity and comprehensiveness for which it would be difficult the world over to find equal. In working hours, wages and conditions, in steps to remove unemployment, and in every kind of social service, the Labour Government had within a year of taking office gone far to set up a new industrial and social Dominion.[1]

But when viewed in conjunction with Labour's other economic experiments such as the Guaranteed Price Scheme, State Housing, Public Works and Monetary Policy, the outlook for the future loses

1 Sir.H.Gullett. Evening Post. Wellington. 14th April, 1938.

some of its brightness. The labour and social policies of the Government, merely places an additional burden on the already overburdened financial system. There is a definite limit to unproductive State expenditure. As far as New Zealand is concerned that limit is determined by our export income. Consequently a substantial fall in export income (which incidentally the Government cannot prevent) will not only prove disastrous to New Zealand's economy, but also to the social institutions which have been grafted on to it.

CHAPTER IX

IMPORT AND EXCHANGE CONTROL.

I Imposition.

II Causes.

III Control and its Objectives.

IV Alternatives.

V Application.

VI Effects.

(I) IMPOSITION.

On December 5th 1938, regulations were gazetted by Order-in-Council giving the Government complete control over overseas exchange transactions and over imports into New Zealand. While the occasion for the imposition of exchange control and import selection was the acute shortage of London Funds which developed towards the close of 1938, the philosophy behind it extends back as far as 1935. Mr. M.J.Savage stated in June 1935 that "The control of trade ---- plus allocation of overseas credits would (a) do away with the necessity of raising the rate of exchange and (b) remove the necessity for protective Tariffs, without leaving Dominion manufacturing industries open to competition with the products of overseas cheap labour."[1]

1 M.J.Savage "The Case for Labour."

Mr.Nash stated in 1935 in connection with marketing and reciprocal trade, that "this policy would first provide for the use of the credit to pay the interest on, and as occasion demanded to redeem, the overseas portion of our national debt. Second, for allocation to importers in New Zealand for the purchase of commodities from overseas --------- confined mainly to the importation of classes of goods that cannot economically be produced in the Dominion."[1] Again import and exchange control was hinted at in the Labour Government's first major act - the Reserve Bank Amendment Act of 1936, when they took control of the Bank's overseas funds. The new legislation altered the function of the Reserve Bank "to give effect to the monetary policy of the Government as communicated to it from time by the Minister of Finance." Finally the Primary Products Marketing Act of 1936 in section 13 (2) provides that where a country provides favourable marketing conditions for our primary produce, the Government "will undertake to arrange through the Reserve Bank of New Zealand that the whole or a substantial part of the financial credits thereby established in such country will be utilised for the purchase of approved goods or classes of goods being the product or manufacture of the country."

Similar instances could be multiplied but the above will suffice to illustrate the fact that although exchange control and import selection divides the history of the Labour Government

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1 Mr.Walter Nash, "Guaranteed Prices - Why and How."

into two distinct phases, this policy was included in their original programme. It is because these measures were adopted at a time when sterling funds were obviously depleted that exchange and import control has been regarded in some quarters as a defensive policy and as a means of salvaging these funds. Import and exchange control have always been implied in Labour's programme.

Between December 1934 and December 1938 net overseas assets declined from £ N.Z. 40.5 m to £ N.Z. 6.8 m. The movement rapidly gained momentum in 1938 and in the absence of drastic Government action these funds would have been completely exhausted in a very short time. Why did they fall? To answer this question various factors must be considered.

(1) <u>Accumulation of Overseas assets 1933-34</u>.

In January 1933 New Zealand depreciated her currency from £ N.Z. 110 to £ N.Z. 125 = £ stg 100, while at the same time the Bank's Indemnity (Exchange) Act of 1933 safeguarded the trading banks against any loss which might result from the sale of any accumulated funds consequent upon depreciation. On commencing operations the Reserve Bank received £ N.Z. 20 m. of these overseas funds and at the end of 1935 the total net overseas assets amounted to £ N.Z. 36.1 millions.

Changes in subsequent years were as follows:

Net Overseas Funds, 1935-38
£(N.Z.)m.

At last Monday in December.	Trading Banks	Reserve Banks	Total
1935	14.6	21.4	36.1
1936	11.5	16.5	28.0
1937	6.7	17.0	27.7
1938	2.1	4.7	6.8

It is difficult to estimate the actual amount of accumulation of funds owing to exchange depreciation and the Bank's Indemnity Act but some place it at £ N.Z. 25 m/

It seems more than probable that some funds were transferred abroad before depreciation in anticipation of deriving a profit from repa triation. On the other hand since it was widely rumoured that the exchange rate would be lowered with improved business conditions, British exporters left payments due on deposit in New Zealand in anticipation of deriving a profit from appreciation of the currency. Importers probably arranged for delayed payments with the same object in view. Likewise it is reasonable to assume that funds were transferred from overseas to New Zealand. Finally there was a decline in imports following the depreciation of the currency. These factors must account for some of the accumulated overseas funds.

(II) CAUSES.

(a) Decline of Net Overseas Assets.

Net Overseas Assets.

At end of December	£ N.Z.m.
1935	36.09
1936	28.08
1937	23.66
1938	6.80

During the three years from 1935 - 38 the funds declined by over £ N.Z. 29 m. The following table gives the visible trade balance and estimated balance of payments for the years 1936-38. There are other payments to be considered besides payments for imports. These include certain invisible items, such as payment of interest on government and local body overseas debt, interest on private debt, payment of pensions, profits on investments and the like. It has been estimated that normally the sum of £ N.Z.12 m. is required for the payment of invisible items. Thus the net balance of payments is arrived at by taking this sum of £ N.Z. 12 m. from the balance of trade.

Estimated Balance of Normal Payments.
£ N.Z.m.

Year	(a) Visible Exports.	(b) Visible Imports.	(c) Balance of Trade.	Balance of Payments. (c - 12 m)
1936	56.7	44.3	10.2	- 1.8
1937	66.7	56.2	12.4	0.4
1938	58.4	55.4	3.0	- 9.0

From these figures it will be noticed that the unfavourable balance of payments would have been about £ N.Z. 12 m over the whole period covered.

By adding the decline in sterling funds to the balance of normal payments we can arrive at a rough estimate of the extent of capital exports.

Estimated Export of Capital.
£ N.Z.m.

At end of December	Decline in Overseas Funds	Balance of Payments	Capital Movements. Annual	Cumulative
1936	8.1	+ 0.4	8.5	
1937	4.3	- 1.5	2.8	13.9
1938	16.9	- 9.0	7.9	21.8

These figures immediately suggest heavy "over importation" but nevertheless certain other factors must be taken into consideration.

During 1936 there were two substantial and abnormal deductions from London Funds. The first was the repatriation of moneys either left in New Zealand or transferred to New Zealand in anticipation of the appreciation of the currency. These funds were returned when it was obvious that New Zealand's currency would not appreciate; if any changes were to be made it would probably be further depreciation. Secondly there was the repayment of nearly £stg 2 m. government stock in August 1937 and £ stg 1.5 m. Southland Power Board bonds in September of the same year. Moreover in 1937 tourist expenditure, especially in connection with the Coronation was exceptionally heavy. The lack of investment opportunities in New Zealand probably accounted for the unusual investments in Australia about the same time. On the other hand, there are certain off-setting factors such as tourist expenditure in New Zealand but this is not of first importance.

(b) Over Importation

By "over importation" is meant importation to such an extent that the excess of exports over imports is not sufficient to pay the annual debt services due abroad. We must now consider the extent of over importation and its effect upon the position of net overseas assets.

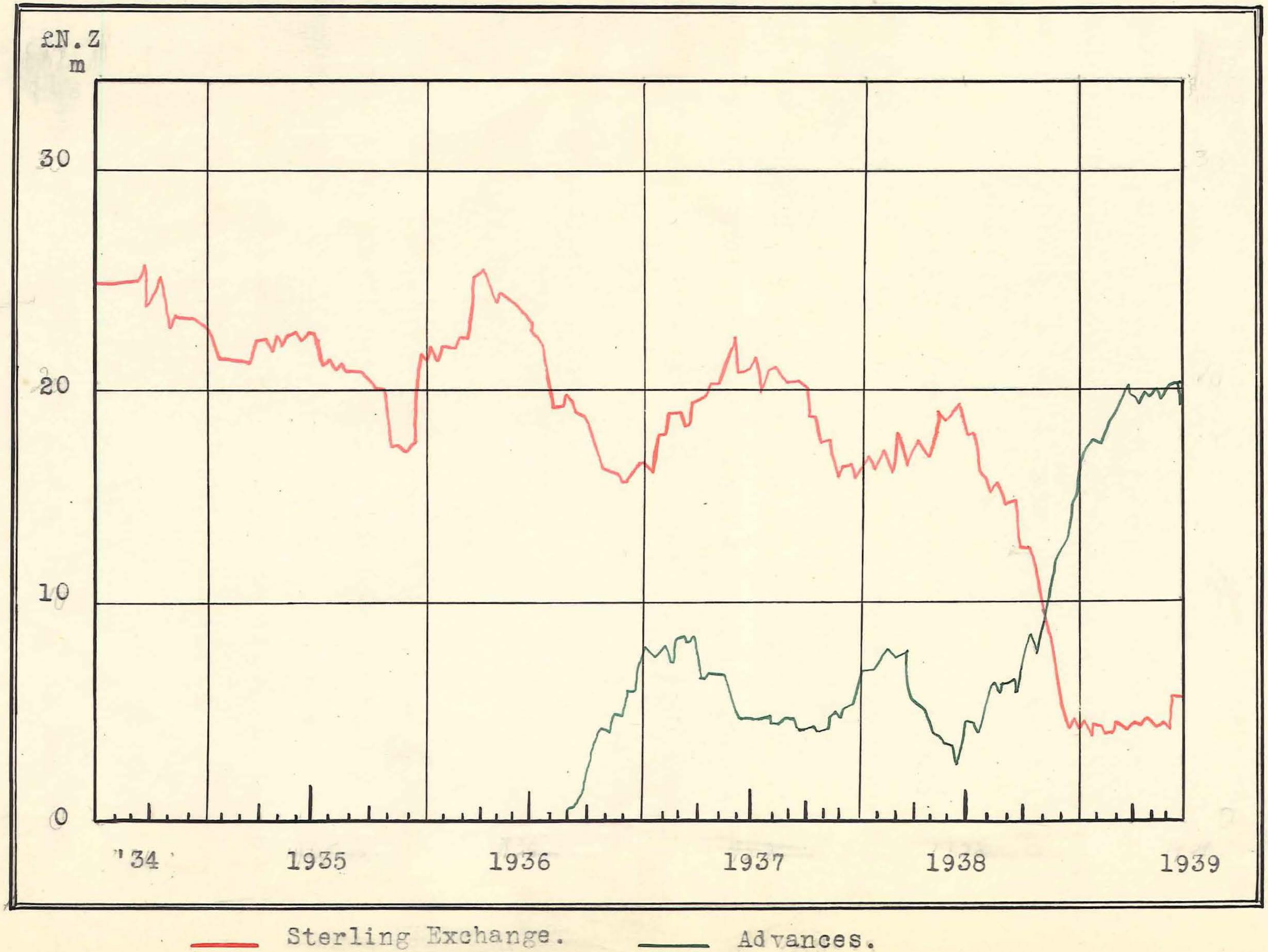
Balance of Trade.
£ N.Z.m.

December	Exports	Imports	Excess Exports.
1935	46.54	36.32	10.22
1936	56.75	44.13	12.64
1937	66.71	56.16	10.55
1938	58.37	55.42	2.95

One cause of over importation was cyclical and a familiar feature of New Zealand's economic history. During the trough of the depression the fall in export income was accompanied by a corresponding decline in imports and continued so for a short period even after export income began to show signs of recovery. With improved economic conditions, imports increased but again when a decline in export income set in during 1937-38, the decline in imports showed a distinct lag. There is a lag in the movement of imports and exports of about one year in New Zealand. This lag must account for some of the decline in the margin of exports over imports in 1938.

But from May 1938 the new factor of expanding Government advances from the Reserve Bank came into operation. Thus during the second half of this year the country's income was considerably increased as a result of these advances to the Government from the Reserve Bank. Moreover the credit expansion that occurred was not confined to the Reserve Bank alone. The facilities of the Trading Banks were used as well. Their resources were increased as a result of the Reserve Bank advances to the Government which were spent in New Zealand. Since the consumption of imports represents approximately one-third of the Dominion's total consumption in normal times it is clear that this increased credit expansion would ultimately influence the volume of imports. In the absence of any special factors any increase in the money incomes of the people in New Zealand would express itself in a corresponding increase in the volume of imports. The expansionist policy of the Government included an expanding programme of public works expenditure which attracted labour from private employment, reductions in working hours and increases in money wages all contributed towards increased purchasing power and higher costs. Advances of the Reserve Bank to the Government increased from £ N.Z. 0.6 m. in June 1938 to £ N.Z. 11m. in December of the same year. The Advances in the Marketing Account averaged £N.Z. 5 m. in 1937 and £N.Z. 4.5 m. in 1938. The combined effect of these measures is the main cause of over importation during 1938, especially the later half.

STERLING EXCHANGE AND RESERVE BANK ADVANCES.



The spending of Government loans from the banking system affected the demand for imports in two ways. First, the Government itself spent much of them directly by heavy importations of machinery for public works undertakings. Such machinery consisted of railway and tramway plant and equipment, iron and steel goods, and heavy machinery such as bull-dozers, dredging and electrical equipment etc. Secondly the policy of redistribution placed in the hands of the lower income groups increased purchasing power through increases in wages, pensions and money incomes. As has already been noted the result of this expansion of purchasing power was an ultimate increase in the volume of imports. And the combined effect of direct Government importation and the importation due to an increased demand for imports on the part of the recipients of increased money incomes was the ultimate depletion of net overseas assets.

(c) The Export of Capital.

In addition to over-importation, the export of capital plays an important part in the decline of sterling funds. This export of capital was due to a variety of causes. The transfer of funds began about May 1938 and continued to the end of the year. It was particularly heavy from August to October during the election campaign.

The extent of this outward flow of capital is difficult to estimate. Estimates range from £ N.Z. 8.6 m. from March

1936 to March 1938. Other investigators have made different estimates. Mr Leicester Webb, (Christchurch Press August 8th 1938) suggested £ N.Z. 20.4 millions as an upper limit from March 1936 to March 1939; Professor H. Belshaw (Economic Record, December 1939) suggested £N.Z. 17.4 millions from December 1934 to December 1938 while Dr. W.B.Sutch (N.Z. Financial Times, May 1939) states that "the total amount of the 1938 abnormal transfer of funds abroad has been estimated at between £ N.Z. 10 million and £ N.Z. 15 million." Although these estimates vary considerably they indicate that a substantial outward movement of private capital took place between March and December of 1938, before exchange restrictions were imposed. An analysis of the long term influences affecting capital movements in New Zealand will serve to throw some light on the causes of this export of capital.

According to the estimates of the N.Z.Official Year Book the total debt for the years 1919-38, excluding public and local body debt movements was £ stg 57.6 million. By including these debt movements a credit of £ stg 14.5 million is obtained. New Zealand has apparently been equating her balance of payments by overseas borrowing. By 1938 such borrowing had amounted to the sum of £ stg 72.1 million and it has been further suggested that these public borrowings were offset on the debit side of the balance of payments by an outward flow of capital. Moreover since 1918 New Zealand has not proved a good field for private investment. The post-war era has witnessed an increasing amount of State interference with the rights of mortgages and a corresponding decrease in the volume of British capital invested in this country. In addition as there is little scope for investment in industrial and commercial securities, profits made with in New Zealand hhave shown a distinct tendency to be invested overseas, especially in Britain and Australia. Previous British investments too may have been withdrawn in favour of better fields of investment elsewhere. Thus from the point of view of the long term export of capital it would appear that the drain on London Funds which caused grave concern towards the close of 1938 can be partially explained as an acceleration of this long term process. But it is important to analyse the factors which caused this acceleration of capital export.

One factor of considerable importance was the low interest rate policy which was introduced into New Zealand during the depression and was designed to provide cheap money and stimulate internal business activity. There can be little doubt that the depressed condition of business activity warranted this measure and most economists would favour a policy of low interest rates but the fact remains that some of the beneficial effects of this policy were lost because of the lack of suitable investment opportunities within New Zealand. Consequently some trading bank deposits were transferred to the Post Office Savings Bank where they were ultimately utilised to finance public works projects. Although the public works policy greatly relieved the problem of unemployment, yet at the same time it had a retarding influence upon private industry. Private industry, by being forced to compete with the higher money wages, and improved working conditions offered by the public works, had necessarily to reduce its margin of profit. Thus private industry did not attract the amount of investment that it would otherwise have done. Under these conditions it is conceivable that investors preferred to exploit fields of investment outside New Zealand.

Allowance must be made too, for the nervous investor who considered his security undermined by the Labour Government, as distinct from the investor who was influenced merely by the return for his investment. Professor Tocker puts it this way:-

> "Since 1935, a farily steady export of capital from New Zealand has taken place and money has been invested overseas, mainly in Australia, where conditions have been more attractive to investors. It is often said that capital is the most timid and the most liquid of all the agents of production. It is readily frightened away when conditions appear insecure and its movements in any particular direction is difficult to detect and stop An investor necessarily looks first for security, and second for return on his capital. In New Zealand during recent years the conditions for investment have appeared insecure and unattractive for several reasons. The compulsory adjustment of contracts between debtors and creditors, during, and since, the depression has not been forgotten and there has been some fear of u further unknown and unpredictable changes in the security of investors in New Zealand. In addition, high and increasing taxation and rapidly rising costs have made the margin from which capital gets its return less than it would otherwise be, and have impaired the net earning capacity of business on which the security of capital ultimately rests. These conditions have been more in evidence in New Zealand than elsewhere.

It follows that since capital is liquid and moves readily, some overseas investors have realised their investments in New Zealand and transferred their capital elsewhere, while some New Zealand investors have found overseas investments more attractive and have sent capital outside the country where relatively greater security or higher returns appears to offer.[1]

Finally the effect of political propaganda playing upon the ignorance and political prejudice of some owners of capital cannot be ignored. It is difficult to estimate the extent to which these various factors were individually responsible for the export of capital from New Zealand but there can be no doubt that the cumulative effect of the above factors was instrumental in reducing the Dominion's net overseas assets to dangerously low levels.

(III) THE CONTROL AND ITS OBJECTIVES.

"The decline in overseas funds which commenced during 1936-37 .... continued steadily, until at 28th November, 1938, the net overseas funds of the Reserve Bank and the trading banks were under £N.Z.8,000,000.

"With a view to conserving overseas funds, so as to ensure that overseas debt services would be met and that sufficient funds would be available for essential imports, regulations - effective from 7th December, 1938, and known respectively as the Import Control Regulations 1938, and the Export Licences Regulations 1938 - were made by orders-in-Council of 5th December 1938.

"The Import Control Regulations prohibit the importation of goods except in pursuance of a license under the regulations or of an exemption granted by the Minister. Under the Export Licences Regulations, goods (with certain minor exceptions) may not be exported except under license.... ... A condition of the issue of an export licence is that the overseas credits arising from the sale of the goods (or used to finance their purchase) must be sold to a New Zealand bank in exchange for New Zealand currency.

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1 Chamber of Commerce Bulletin Nov.1938 No.

"From 7th December,1938, also, the Minister of Finance has suspended the obligation of the Reserve Bank to give sterling in exchange for its bank notes." [1]

In introducing this new legislation the Government intended tc maintain the exchange rate at its present level and to prevent the free buying and selling of sterling exchange by subjecting each transaction to official approval. The Reserve Bank was to be utilised as a central pool for receiving the whole of the receipts from export sales and as a medium of making such payments which were officially approved. In this way it would be able to control capital movements from the Dominion.

The new legislation placed no restrictions on exports from the Dominion;its purpose was the concentration of export receipts in a central pool. But imports were to be drastically limited and rationed. One aim of import control was to give a preference to imports from the United Kingdom and others units of the Empire. The Government indicated also that the exchange funds available would be used, firstly to meet our overseas debt commitments,both public and private, and secondly to purchase imports from the United Kingdom and finally provision would be made for the importation of materials and equipment, necessary to develop our secondary industries.

It is necessary to understand clearly the objectives of

1 New Zealand Official Year Book 1941 p 198.

this control. It has already been pointed out earlier in this chapter that import and exchange control have always been implied in Labour's programme. But it is equally clear that the imposition of import and exchange control was forced upon the Government by the serious depletion of London funds in the second half of 1938. Professor H. Belshaw writing in the Economic Record, December 1939 regards the control as "primarily a salvage operation." The reluctance of the majority of Labour to realise the prime importance of London funds and the peculiar sensitive dependence of New Zealand's economy, together with the confused thinking surrounding this aspect of policy probably accounts for much of the delay in the initial applications of control.

Having imposed control, the Government exploited this opportunity of furthering its policy of expansive economic planning of which up to this time much had been heard but little achieved. The leaders of the Government lost no time in pointing out the advantages of the new legislation: that it would quickly relieve the serious plight of sterling funds; that it offered distinct possibilities of expanding the Dominion's secondary industries and that it would provide the machinery for avoiding future crises with our net overseas assets. On the other hand opponents of the Government were equally quick to point out the obvious disadvantages of the scheme: that there would be chaos in the initial stages of the application of the licencing scheme; that the readjustment of trade to a certain extent would be necessary; that the burden of administration would be heavy and that bureaucracy would increase at the expense of demorcratic liberty in this sphere; that the quality of New Zealand manufactured goods would prove inferior to imported goods; that the prices would rise before control could become effective and that in the international sphere investors would be further frightened away and that retaliatory measures would probably follow.

The objectives of Import and Exchange Control stated by the late Prime Minister, the Right Honourable M.J.Savage, and Minister of Finance, the Honourable Walter Nash, were as follows:

(1) "To safeguard exchange funds so that debt services might be met, and the position improved for pending conversion operations.

(2) "To provide the means for "essential imports", which might be expected to include raw materials, requisites for primary industries and goods which could not be economically produced in New Zealand. Sterling exchange was to be rationed in the following order of preference.

1. Government debt services.
2. Local body debt services.
3. Private debt services.
4. Machinery for public works and defence.
5. Machinery for primary and secondary industries.
6. Raw materials for industries.
7. Other necessities not produced in New Zealand.
8. Luxuries.

(3) To increase the production of consumable goods in New Zealand.

(4) To give preference to the United Kingdom while still abiding by agreements with other countries. Control therefore involved selection according to country of origin.

(5) To promote trade agreements based upon "earmarked" exchange.

(6) To insulate New Zealand against unfair competition.

(7) Generally to improve the standard of living while avoiding the depletion of exchange funds.

(IV) ALTERNATIVES:

Since 1938 much has been written about what would have happened had the Government been less ambitious with its public works policy, and had they arrested the financial drift long before December 1938, but much of this is merely idle chatter and apart from being a guide to future policy, is of academic interest only. We are not concerned at the moment with the various methods whereby the crisis could have been avoided; we are concerned solely with the alternative methods which the Government could have applied to deal with the crisis after it had arisen.

The first alternative perhaps, dealing with the depletion of London funds would have been a form of exchange rationing by the banks themselves. This method would have been quite sufficient had it been the aim of the Government merely to control overseas funds. But Government policy as has already been noted extended far beyond this, and so by the very nature of Government policy this method was ruled out.

A second method would have been to vary the exchange rate either by pegging it at a higher level than the present one (£ N.Z.125 = £ stg 100) or by unpegging it and allowing it to fix its own level. This policy would have the manifold advantage of reducing imports, affording further protection of New Zealand's secondary industries, arresting the drain on capital and most important of all it would have assisted the farming community by raising their money incomes. Moreover this policy had been tried before in 1933, proved successful and was familiar to New Zealand. On the other hand the raising of the rate of exchange in 1933 had provided the then Labour Opposition with substantial grounds for criticism of the Coalition Government and a repetition at this stage would have the double disadvantage of being an open confession of the failure of Labour and of being unpopular with the wage earning sections of the community. In addition it is probable that the effects of this measure would have been too slow to salvage London funds.

A third alternative would have been to raise a substantial loan overseas as a means of restoring London funds to a safe level. At best this would prove a temporary measure only. It suffered from the disadvangage of being opposed to Labour's traditional policy, (that of being freed from the "debt slavery") and of being difficult to implement since the Dominion was in the unfortunate position of having to ask accommodation from London. Unless the Government were prepared to reverse their radical policy, a loan, if it were possible to obtain, would have provided but temporary relief.

The method of rationing exchange under the Import and Exchange Control Regulations has been severely criticised in many quarters as being irksome, costly and cumbersome. As an alternative, rationing of exchange by the banks has been advocated. Professor A.H.Tocker supported this policy as follows:

> "- - - - - Rationing of exchange by the banks has been tried and proved in the past as a swift and effective method of control. It is simple and the least inconvenient of all the methods, and the banks possess the knowledge, experience, and the organisation to operate it effectively. It was used in 1921 and again in 1931 when overseas funds were very short, and on both occasions was followed by the speedy restoration of normal trading conditions." 1

This is doubtless very true and may have been the method adopted by the Government had their aim been merely to restore London funds. But as has already been noted, Government policy had another aim as well; to further its policy of expansive economic planning within New Zealand, and for this reason rationing of exchange by the banks was politically inexpedient.

Other alternative measures would have been to impose

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1 Chamber of Commerce Bulletin, No 175, August 1939.

higher tariffs, the raising of interest rates aimed at internal deflation or a radical change of Government policy. But again these measures were ruled out as being politically impracticable. By the very nature of Government policy there was only one avenue open to it.

By December 1938 the Government was faced with a serious dilemma. The loss of London funds had gone beyond the limits of safety and it was forced either to abandon its radical economic policy or to adopt stringent methods of control. The above alternative methods of dealing with this crisis, if applied earlier might have proved successful but they were opposed to Labour's traditional policy and were therefore politically inexpedient. To abandon their radical economic policy would have been an unconditional confession of failure, it would have precipitated a crisis within the Party itself. By imposing Import and Exchange control the Government chose the only real alternative available.

(V) APPLICATION:

In introducing this new legislation it was obviously impracticable to widen the margin between exports and imports from the side of exports. Clearly too, it is fundamental to the welfare of New Zealand to maintain exports at the highest level possible. Export prices are always beyond the control of New Zealand, and in any case the increasing of the volume of exports cannot be achieved overnight by Orders-in-Council. Imports therefore must be reduced. To give effect to this policy two things were required; to control the supply of exchange and the demand for it.

To cope with the first of these problems the Export Licencing Regulations were enacted. Export of goods could only be effected under a Government licence and the proceeds must be paid into local or London branch of a trading bank, whence they would subsequently be transferred to the Reserve Bank in exchange for New Zealand currency. This amount would then be credited to account of the licencee. This had the effect of giving the Reserve Bank a monopoly of exchange accruing from the proceeds of export receipts. It is not surprising under these conditions that a "black market" should develop in connection with finance drafts payable on banks outside New Zealand.

The Import Control Regulations were designed to regulate the main demand for sterling exchange. The first problem for the Government was to decide to what extent the demand for imports should be curtailed and this could be decided only by estimating the amount of exchange available for imports after making due allowances for the amounts required for both building up London funds and for the payment of interest on overseas debt, public as well as private. It has been estimated that £N.Z.12 million is required annually to meet the Dominion's interest bill and the amount of £N.Z.5 million is allowed for the restoration of London funds to a safer level, giving a total in round figures of £N.Z.17 million. The balance of trade figures for the year ended June 1939 (working on the 1938 figures) would have been as follows:-

Trade Balance.
(£N.Z.m)

Exports.	57.8
Imports.	55.4
Excess Exports.	2.4

This would mean in other words that the Dominion's imports would have to be reduced by about £N.Z.15 million.

The Import Control Regulations empowered the Customs Department to issue licences to importers and the Reserve Bank was empowered to issue permits for overseas payments arising from these licenced imports. Imports were prohibited except under official licence or special permission of the Minister of Customs. In this connection the Minister was vested with extremely wide powers, in that he could grant, modify, or refuse a licence. In addition provision was made for appeals against the conditions of any licence, or the refusal of the Department to grant a licence. Since it was also the aim of the Government to expand secondary industries within New Zealand as well as to restore London funds, the Department of Industries and Commerce was consulted in connection with the granting of licences or hearing of appeals.

There were many obstacles preventing the effective operation of the new scheme of import control. First, confusion between the banks, Customs Department and the Government accentuated the administrative difficulties. Importers in particular were handicapped by the lack of a clear-cut statement of Government policy regarding the list of restricted and prohibited imports and the carry-over of licences after the expiration of the first half-yearly period of control. In addition it was not altogether clear whether the Government intended to make control permanent or use it merely as a means of restoring London funds to safer levels. Had the Government intended merely to restore London funds the situation could have been easily and speedily remedied. But that was not the case. The Government had given every reason to believe that control would be a permanent institution, and that they intended to use it in addition, as a means of expanding local production and of protecting New Zealand's secondary industries. To expand local secondary industries within New Zealand it was necessary to make provision for the importation of increased quantities of raw materials, semi-finished goods and capital equipment. This meant that certain classes of goods would have to be further restricted if the Dominion's overseas assets were to be restored. Importers were consequently placed at a further disadvantage on account of the uncertainty of the types of goods which they would be permitted to import in the future and by the failure of control to achieve its objectives in the first half of 1939. Accordingly, a conference of importers submitted the following recommendations to the Government.

"That, having regard to the following Government objectives.

(1) Conservation of sterling.
(2) Protection of local manufactured lines.

(3) Alterations in the direction of trade".

the Government should:

"(1) fix the amount of sterling each importer can use for twelve months, based on, say, two or three years' average imports less whatever percentage the Government considers necessary to conserve sterling funds.

(2) Protect local articles of manufacture by listing those which are prohibited or restricted by means of a permit.

(3) Vary the direction of trade by listing items subjected to restriction from certain countries."[1]

The Government, however, decided to continue with its present technique of administration and to impose even heavier restrictions upon imports for the second half of 1939.

We can now consider some of the more important effects of Import and Exchange Control.

(VI) EFFECTS upon:

(a) Imports.

During its first half year of operation, the policy did not achieve its object of restricting imports. Failure was due to a variety of causes, chief of which were the fact that some orders had been placed prior to the introduction of control, some shrewd importers may have placed orders in excess of their

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normal requirements, the importation of certain raw materials essential for establishing secondary industries within New Zealand and possibly the fact that licences granted had to be made effective during this period. The following table gives a comparison of the imports for 1938 and 1939 (first half).

£ N.Z. m.

	1938	1939	Difference.
First half year	27.11	28.19	+ 1.08
Second half year	28.31	21.20	- 7.11
Total	55.42	49.39	- 6.03

Exports during the same period had declined from £ N.Z. 58.38 m in 1938 to £ N.Z. 58.01 m in 1939. It will be seen from the above table that, although control had failed to achieve its objective in the first half of 1939, some improvement was nevertheless effected during the second half of that year. The excess of exports over imports was £ N.Z. 8.6 m which fell short of the amount of £ N.Z. 12 m necessary to balance the "invisible" items in the balance of payments. Consequently the Minister of Finance was despatched to London to raise a loan.

(b) Exchange Funds.

Although there was a favourable trade balance of £ N.Z. 8.6 m , London funds did not accumulate as was anticipated. Various factors were responsible for this failure, chief among which was the continued export of capital through various channels. Leakages were occuring through the trading banks, the Post Office, and to some extent through the development of a "black market," After six months of operation there were ample grounds for believing that Import and Exchange Control had failed to achieve their prime objective. The following table gives the position of net overseas sassets during the first six months of control.

Movement of Exchange Funds.

Month	£ N.Z.m.
1938 December	6.80
1939 January	7.26
February	9.06
March	9.27
April	9.00
May	7.39
June	9.09

(c) Prices:

The effect of control on prices was not felt fully during the first half year of operation. This may be explained by the fact that the Government's expansionist policy was still expressing itself in increased imports and some export of capital As soon as the control became more effective and imports were drastically reduced in the second half of 1939, the full weight of the Government's policy began to fall on economic conditions within New Zealand. Consequently prices showed an upward tendency. The following table will make these points clearer.

Index Numbers of Wholesale and Retail Prices.

	Wholesale (1913=100)	Retail (1914=100)
1938 First Quarter	153	150
2nd "	152	151
3rd "	151	151
4th "	153	151
1939 1stt "	154	154
2nd "	155	156
3rd "	157	158
4th "	163	161

(d) Internal Business.

Since the volume of import trade in relation to total trade is high in New Zealand and enters into economic activity of all kinds to such an extent that very few industries are not affected by it, it follows that a heavy reduction of imports as contemplated by the Government must produce serious effects upon internal business activity. This was more especially the case when it was intended to expand secondary industries at the same time, for such expansion would necessitate increased importations of producers goods and raw materials. This in turn would mean that even further drastic reductions of other imports would have to be effected. The following table of the Classification of imports will serve to illustrate this point.

Classification of Imports 1938.[1]

Class	£ N.Z. m.	% of Total
Producers' Materials	17.53	31.6
Producers' Equipment	7.04	12.7
Fuels and Lubricants	3.03	5.5
Transport Equipment	8.13	14.7
Consumers goods	14.16	25.5
Other	5.53	10.0
Totals	55.42	100.0

This table shows that over 44 percent of total imports consisted of producers materials and equipment. In order to maintain internal production at its existing level, this amount would have to be retained at least. If secondary industries were to be expanded this amount would have to be increased. Admittedly some local manufacturers would stand to gain from

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such a policy, but this section of the manufacturing industry is not large in New Zealand. Much of New Zealand manufacturing is concerned with the processing of primary products, or repair trades; relatively little is concerned with purely secondary industries. In addition production both primary and secondary would have to bear the additional burden of rising costs and prices consequent upon the policy of control.

In conclusion it may be said that manufacturers greeted the scheme of control with enthusiasm, although importers have experienced real difficulty in obtaining permits and have consequently suffered. The Government must be given some credit for attempting to meet the crisis with measures which would spread the burden and not unduly penalise the wage earners and for endeavouring to maintain their programme of social and economic reform, even if they failed to realise the more important implications of such a policy. On the other hand, it must be clear that the standard of living of the Dominion must fall; the consumer must suffer through higher prices, inferior goods and a narrower range of selection; and the producer must suffer also through higher prices and costs. The crisis was brought about largely by the Government's own expansive economic policy and the failure to improve the position early in 1939 was due largely to the Government persisting with its same policy, even though there may have been some scope for a certain amount of economic planning within New Zealand.

Fortunately for New Zealand perhaps, and unfortunately for the rest of the world the outbreak of war in September 1939, shifted the Government's economic problems to a different plane.

CHAPTER X

CONCLUSION.

The purpose of this inquiry was to describe and analyse the more important aspects of the Labour Government's economic policy during its first four years of Office (1936-1939), and to demonstrate how the achievement of this policy is conditioned by the characteristics of the New Zealand economy. Before proceeding to attempt an evaluation of this policy it will be convenient to restate briefly the original aims of Labour Government which were formulated at a Paaty Conference in 1933. The aims were:-

(1) The State control of Banking and Credit.

(2) Removal of restrictions on deposits in the Post Office Trading Bank.

(3) Reorganisation of the Mortgage Corporation into a State Advances institution.

(4) A guaranteed price prodedure for farmers.

(5) Statutory minimum wages and salaries.

(6) A National Health Service.

(7) National superannuation.

(8) Extension of educational facilities.

(9) Reorganisation of employment with immediate increases of rates of relief pay and expansion of public works.

(10) The expansion of secondary industries.

It is important to remember however, that the paramount objective of the Government was the reduction of unemployment.

From the foregoing discussion in connection with the economic experiments of the Labour Government during the period under review, it is now possible to draw certain conclusions regarding the achievement of these experiments, and to establish some fundamental principles upon which any programme of economic reform in New Zealand must be based.

Thus by 1935 it was shown that economic conditions were again approaching their pre-depression level and New Zealand was well advanced on the road to recovery. This meant that the original programme which was laid down in 1933, was more applicable to the conditions then prevailing, than to those which were actually in existence when the Labour Government assumed office at the end of 1935.

In the Preamble to the programme it was emphasised that overseas prices and conditions would no longer be allowed to dictate New Zealand's standard of living, and that by proper planning of production and the intelligent use of credit New Zealand would be able to establish its own standard of living. This belief, to say the least, is quite fallacious for the simple reason that, by virtue of the "dependence" of the New Zealand economy, export prices impose very definite limitations upon the standard of living. When the value of export receipts increase, the real income of New Zealand is raised, but when this value shrinks, real income falls. No amount of monetary manipulation can alter this fundamental fact. The failure to recognise this fact, together with the confusion of money income and real income, which is deep rooted in Labour's philosophy were the basic causes of many of the Government's difficulties, especially those in connection with their financial policy. For instance, when the Government was no longer able to finance its various undertakings from current revenue and loans from departmental sources, it proceeded to finance them directly by advances from the Reserve Bank. This expansion of excess credit unbacked by saleable goods, was the main cause of the rapid depletion of net overseas assets in the second half of 1938. The Government was f then faced with the alternative of abandoning its radical programme or of drastically curtailing imports. Naturally it chose the latter course, which was the only one open to it. But this did not enable the Dominion to escape the consequences of a too liberal financial policy.

With the imposition of Import and Exchange Control, the effects of further credit creation were to fall with full force upon internal economic activity, thus exerting an upward pressure on prices and costs. This in turn adversely affected the Government's policy of stabilisation, particularly the guaranteed price procedure.

Although Import and Exchange Control was aimed primarily at salvaging London funds, full advantage was taken of this opportunity to expand secondary industries in an endeavour to produce locally the goods which could not be imported. This policy has not succeeded, mainly because New Zealand is not favourably endowed with the resources necessary for industrial development. The fact is of course that an expansion of existing small scale industries is possible only at higher real costs than those at which imports could be purchased, and therefore a fall in the standard of living must follow.

It should now be quite clear that real income cannot be maintained, let alone increased, by a mere increase in money income, and that the trend of events in the outside world reduces New Zealand's real income, no amount of monetary manipulation can prevent the standard of living from falling. This means that, whatever the monetary policy followed New Zealand must necessarily live within its real income, and limit its consumption to the value of its production.

In the sphere of price fixation the Government has experienced considerable difficulty. The history of the guaranteed price scheme for dairy prodcue shows that the trend of prices so far has been in one direction only, namely upwards. This is of course inevitable, so long as the Government continues with its inflationary financial policy which increases the farmers' costs of production. Consequently the Government must either yield to the demands for higher prices and therefore increase the dangers arising from a series of deficits in the Dairy Industry Account, or else it must attempt to stabilise prices and run the risk of antagonising the farming community. The first alternative, if continued over a number of years, would wreck the guaranteed price procedure altogether, while the second would be an act of political insanity, especially for a Government which has b to face an election every three years. Future prospects are therefore not encouraging.

It is important to notice too that, because of the lack of well organised consumers' co-operatives in New Zealand, the various price fixing schemes, including wheat control have benefited the producers at the expense of the consumers.

It was demonstrated that the achievement of the Government's policy for the rationalisation of industry, which effected some improvements in the marketing of farming produce left much to be desired in other branches of industry. This was especially true of the transport industry. There was no evidence to suggest that the Government had formulated a deliberate and considered policy, in fact it restored direct political control of the railways, despite the fact that the 1930 Committee of Investigation maintained that this political control was nthe root cause of many of the railways' difficulties. Regulation of the transport industry has been largely concerned with the licensing of motor transport. In addition this branch of the industry has been subjected to heavy taxation for purposes other than road construction and maintenance. On the other hand, despite the fact that the railway returns during recent years have shown a deficit of nearly £ N.Z. 2 m. annually, the Government persists in constructing new railway lines involving a heavy expenditure of public money. When completed these lines will be less likely to meet their running costs, than those already in operation. Far from effecting the co-ordination of road and rail transport, the Government has merely descriminated heavily against motor transport and in favour of the railways which are State owned and operated.

It will be recalled that the paramount objective of the Labour Government was the reduction of unemployment. With this end in view a vigorous programme of public works was undertaken, a forty-hour week introduced, and the rates of pay increased, with the result that public employment expanded considerably. It was hoped that with the expanding wave of business prosperity, there would be a progressive transfer from public to private employment. But this was not the case. In the field of agriculture, for instance, employment registered a slight but persistent contraction. The failure of private industry to absorb an appreciable number of the unemployed may be attributed to the fact that the Government had superimposed a vigorous programme of public works on a boom period in the trade cycle and therefore private industry found it increasingly difficult to compete with the higher wage rates and the improved working conditions of public employment. Moreover, because these improved working conditions and wage rates meant a narrower margin of profits accruing to private industry, this field of investment proved less attractive, with the result that private industry did not expand as would otherwise have been the case. In this way Government policy, hindered rather than helped the transfer from public to private employment.

On the other hand, as might be expected, marked increases were registered in industrial and factory employment and also in the constructional industries.

It is significant that the measures adopted to combat unemployment were palliatives only; they do not attempt to remove unemployment by removing the economic dislocations which caused it.

Another important objective of the Government was the redistribution of income. Accordingly expenditure on social services, especially in connection with the Social Security Scheme, was greatly increased and extended. While it cannot be denied that the lower income groups have benefited to a considerable extent by this redistribution, the fact remains that the unproductive expenditure of the State has been increased tremendously. Expenditure on social services alone has increased from £ N.Z. 7 million in 1936 to £ N.Z. 19 Million in 1940.

The achievement of the Labour Government's economic policy must not be judged by any one particular aspect alone; the policy must be considered as a whole. On the one hand it may be concluded that New Zealand is now better equipped to meet another depression and to cope with the problems of post-war reconstruction. It has now such economic controls as a State central bank, an import selection policy, the control of foreign exchange, a measure of price control, State marketing machinery and a Social Security Scheme. On the other hand it would appear that in its enthusiasm to give effect to its radical programme, the Government has endangered the very foundations upon which its success depends. In other words it has placed additional burdens upon an already overburdened system of State finance, without giving adequate consideration to the factors which govern the sources of public revenue. In particular the Government appears to have almost completely overlooked the vital role which export prices and overseas markets play in the prosperity of the Dominion. Moreover, not only did the confusion of money income with real income prove a source of difficulty, but it actually enticed the

Government to embark upon a too liberal financial policy with disasterous effects upon New Zealand's net overseas assets.

From the foregoing discussion it should now be possible to establish the following fundamental principles upon which any programme of economic reform in New Zealand must be based. First the real income of New Zealand is largely governed by export receipts, and the success of any such programme depends upon their bouyancy. Second, the fact that overseas prices can determine the fate of the Dominion's prosperity, demonstrates clearly the economic inter-dependence of the modern world and the urgent necessity for creating the machinery necessary to establish closer economic international co-operation. Thirdly, the trend to events during recent years in New Zealand shows only too clearly that although economic nationalism may control the national economy, it can go no farther; it cannot restore real prosperity. That depends upon the restoration of trade.

Finally economic welfare tends to be greatest with full production and exchange, for all consumption necessarily depends on production and exchange. The policy followed in recent years has succeeded in transfering both men and resources which were normally productively employed into unproductive channels, such as unproductive public works and unessential administrative services. This policy has also lost sight of the necessity for maintaining economic balance among the various factors making up the national economy. It has sadly disturbed the normal balance and seriously retards the operation of these prices by which, in a freer economy disturbances in balance are corrected. New Zealand has therefore still to solve the problem of securing a balanced working economy in which the fullest production and the most equitable distribution of the kinds of goods and services most needed by the community will be achieved.

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